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# European Initiatives (PECL, DCFR) and Modernisation of Latvian Civil Law

## 1. Introduction

Latvia has codified (to be more precise, partly codified) her civil law. The civil law as a codification act (the Civil Code)<sup>1</sup> was adopted in 1937, shortly before the occupation, and re-enacted in the independent Latvia of 1992–1993. The Civil Code is based on the Local Law Collection of the Baltic Provinces of the Russian Empire (1864), the main drafter of which was Friedrich Georg von Bunge, well known in Estonia. As a result of his contribution, the Civil Code to a greater extent resembles the German *Bürgerliches Gesetzbuch* (BGB), rather than any of the Russian codes. Although the Civil Code contains 2400 articles, its coverage still does not include some important parts of the civil law, such as insurance. At the same time, the Civil Code comprises only symbolic general chapters in relation to such important areas as labour law and carriage of goods and passengers. Instead, employment relationships are regulated by the 2001 Labour Law<sup>2</sup>, whereas the field of transportation is governed by the 2000 Railway Carriage Law<sup>3</sup>, the 1995 Motor Carriage Law<sup>4</sup>, the 2003 Maritime Code<sup>5</sup>, and other special laws. The Construction Law of 1995 supplements the rules of the Civil Code on work-performance contracts. Insolvency law, competition law, copyright law, commercial law, and consumer protection law exist as branches of special private law.<sup>6</sup> In 1997 Latvia ratified the Convention on International Sales of Goods (CISG).

In 2000, the Commercial Law was adopted. However, at that initial stage only three out of four parts were approved. It was only after a lengthy interruption until September 2007 that work on the code resumed and the draft of the missing final part D, “Commercial transactions”, was submitted to the Latvian Parliament (*Saeima*) and passed at its first reading on 15 November 2007 and at its second reading on 28 February 2008. Part D contains provisions specific to commercial transactions.

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<sup>1</sup> The Civil Law of Latvia. Riga: Translation and Terminology Centre 2001.

<sup>2</sup> Doc. No. EO223[1], Translation and Terminology Centre. Available at <http://www.ttc.lv/index.php?id=10&tid=50&l=EN&seid=down&itid=13779> (15.09.2008).

<sup>3</sup> Dzelzceļa pārvadājumu likums. – Latvijas Vēstnesis, 5.01.2001, No. 3 (in Latvian).

<sup>4</sup> Autopārvadājumu likums. – LR Ziņotājs, 1995, No. 20 (in Latvian).

<sup>5</sup> Jūras kodekss. – LR Ziņotājs, 2003, No. 14 (in Latvian).

<sup>6</sup> K. Balodis. Latvian Private Law and European Enlargement. – M. Bassani, U. Mattei (eds.). Opening up European Law. The Common Core Project towards Eastern and South Eastern Europe. Berne: Stämpfli Publishers 2007, pp. 223–231.

The intensive development of private law that took place prior to Latvia's accession to the European Union can be considered very successful, as indeed for all three Baltic States. In connection with EU accession, it was not necessary to amend the Civil Code's chapters on contract law and property law, though some amendments were made to the chapter on family law. Necessary directives were implemented mainly through adoption of separate laws (*lex specialis*), such as the Consumer Rights Protection Law, the Law on Safety of Goods and Services, and the Law on Liability for Defects of Goods and Services. This is not to say that no amendments were made to the code as such. Indeed, some new rules, such as rules on delayed payments and interest (deriving from directive 2000/35/EC), were introduced into the code.

## 2. Relative stability and future plans

Currently, development of private law in Latvia is mainly proceeding through implementation of EU directives. This is perceived as a high priority by the domestic legislator. Official information on the Web page of the Ministry of Justice states that Latvia has already implemented 1694 directives, or 99.59% of all directives to be implemented.<sup>7</sup>

Some attempts to introduce directives into the Civil Code reveal problems that should also be taken into consideration by drafters of directives. The delay in implementing some directives shows that the problem does not lie in the unwillingness of Latvia to implement them but, rather, in the way the directive provides resolution to, for example, non-discrimination issues. No political groups in Latvia support discrimination. However, a number of Latvian sectoral ministries and the parliament have been unable for two years to decide how, and in which law, to implement the directive on equal treatment of persons, irrespective of racial or ethnic origin, and the directive on equal treatment of men and women in access to and supply of goods and services.

One draft provided that these issues would be addressed in the Civil Code's chapter on contract law. However, along the way, a number of problematic issues were identified, such as:

1. Whether other forms of discrimination, which are not listed, would be permissible in public supply of goods and services, for example, on the basis of religion, age, and political views.
2. Whether the prohibitions apply only to public supply in the goods and services sector, or whether they should be applied generally and therefore be included in the introductory chapter of the Civil Code.
3. While working on these issues, the drafters have realised that the directive also applies to commercial relationships. This led to elaboration of another draft law – Amendments to the Commercial Code — setting out a list of prohibitions, which ended by saying “[...] based on gender or other basis”. No progress on any of these draft laws can be reported so far.

With regard to initiatives not derived from directives, it must be said that doctrine and academic proposals are developing more rapidly than their implementation in specific legislative drafts. The necessity for modernisation is currently recognised mostly by academics and their students, who in their research and studies are focusing much more on private law processes in Europe. Many papers were published in 2003–2007<sup>8</sup> comparing the concepts of the Principles of European Contract Law, the UNIDROIT Principles, and available parts of the Draft Common Frame of Reference (DCFR). A doctoral thesis entitled “Main Modernization Directions of Latvian Contract Law” was defended by Janis Karklins. This suggests a firm theoretical foundation. But it is not sufficient for legislative activities.

As the situation stands now, state institutions, and in particular the Ministry of Justice and the parliament, find other drafting matters more pressing, such as criminal law, competition, insolvency, and reorganisation of the court system. Nevertheless, the Civil Code has not been forgotten, although research is scheduled for 2007–2009 — but only on **possible** modernisation. Work has started on elaborating an inventory of gaps and out-of-time rules in the Civil Code. More than 100 provisions contained in the Civil Code's chapter on contract law were found not to correspond to today's requirements from the standpoint of their wording, as

<sup>7</sup> Available at [http://www.tm.gov.lv/lv/jaunumi/tm\\_info.html?news\\_id=1679](http://www.tm.gov.lv/lv/jaunumi/tm_info.html?news_id=1679) (15.02.2008).

<sup>8</sup> K. Torgans. Eiropas Jurisprudences vērtības civiltiesībās: pārņemt vai nogaidīt (Values of European Jurisprudence: To Adopt or to Keep Waiting). – *Jurista Vārds*, 20.11.2007, No. 47 (500), pp. 17–19 (in Latvian); K. Balodis. Proposed Regulation of Commercial Transactions in the Commercial Law of Latvia. – *Humanities and Social Sciences Latvia. Current Topics in Latvian Law 2003*, pp. 1010–140; V. Jarkina. Ceļā uz Latvijas Republikas Civillikuma modernizāciju (On the Way of Modernisation of the Civil Law of Latvia). – *Jurista Vārds*, 19.06.2007, No. 25, pp. 9–10 (in Latvian); K. Torgans. The Concept of Fault in Latvian Contract Law Requires Adjustment. – *Humanities and Social Sciences Latvia. Current Topics in Latvian Law 2003*, pp. 96–1009; K. Torgans. Contract Law: Latvian and European Union. – *Problems of Transformation of Law in Connection with European Integration. International Conference. Rīga 2002*, pp. 24–39; K. Torgans. Komerclikumā jāiestrādā Eiropas līgumu tiesību principu normas (The PECL Rules should be Introduced into the Commercial Law). – *Jurista Vārds*, 20.02.2007, No. 8, (461), pp. 1–4 (in Latvian); V. Jarkina. Vai sabiedrība ir gatava grozījumiem Civillikumā (Is Society Ready for Amendments to the Civil Law). – *Jurista Vārds*, 6.11.2007, No. 45, pp. 14–16 (in Latvian).

well as for the precision of a proposed solution. However, most changes are technical, and no more than 15 fundamental conceptual amendments could be highlighted. This has fuelled discussion on whether introduction of amendments will be enough or whether a completely new version of the civil code should be prepared. However, creating a new civil code is an enormous legislative task, justifiable only by very strong grounds recognised at government level.

### 3. The first bundle of important amendments

In summer of 2007, the fourth part of the Commercial Law, drafted by a group of young academics engaged by the Ministry of Justice, was completed. During public discussion of its general portion on commercial transactions, the idea came up that more provisions should be included, such as those recognised in the PECL, UNIDROIT Principles, and CISG alike. Seven draft articles were proposed at a meeting organised by the Latvian Lawyers' Society, also attended by representatives from the Ministry of Justice, including the Minister himself.

The proposed provisions are the following:

**First of all**, to soften categorical application of the *pacta sunt servanda* principle, by introducing a 'hardship' concept (as provided by article 6.2.2 of the UNIDROIT Principles) and negotiations on amendments to the contract (UNIDROIT Principles article 6.2.3).

**Secondly**, to introduce a concept of 'fundamental non-performance' as formulated in article 7.3.1 of the UNIDROIT Principles, article 25 of the CISG, and article 8:103 of the PECL, as the basis for terminating a contract, consequently softening the *pacta sunt servanda* principle, also demonstrating that termination for minor breaches is not permissible.

**Thirdly**, to introduce a concept not previously contained in the law — namely, an 'additional period for performance' (PECL article 8:106).

**Fourthly**, and quite revolutionary for Latvia, to prepare an amendment concerning foreseeability of loss and its remoteness (PECL article 9:503 and UNIDROIT Principles article 7.4.4):

The non-performing party is liable only for the loss which it foresaw or could reasonably have foreseen at the time of conclusion of the contract as a likely result of its non-performance, unless the performance was intentional or grossly negligent.

Although such provisions may seem quite obvious to law specialists from other countries, thus far they have not been included in the Latvian Civil Code.

Finally, three other proposals were made, concerning the jurisdiction of the courts to decrease unreasonable contractual penalties, mitigation of loss, and the less well-known 'reminder or warning on duty to pay interest' to be required for charging interest after recovery of the main debt.

A couple of weeks later, the first official reaction was that the **draft provisions are not bad** but that those that do not give rise to doubt must be included in the Civil Code, as the Commercial Law is *lex specialis* in relation to the General Provisions of the former. Consequently two options collided:

- a) to introduce modern regulation only for commercial transactions in, for example, the Commercial Code to test these provisions, and then to expand their application by introducing them into the Civil Code and
- b) to amend the Civil Code.

Preference was given to the option of amending the Civil Code.

Deliberations on amendments submitted for comment to ministries and other institutions revealed a number of arguments that probably should be forwarded to EU legal scientists and institutions.

Firstly, and quite unexpectedly, it was noted that some provisions are unnecessary, as the general principles in the Civil Code are enough. For example, the principle of good faith should be applied (Civil Code article 1). Additionally, it was observed that no examples exist of cases that the courts have failed to resolve as a result of lack of legal provisions.

Secondly, it was noted that some CISG provisions are not guaranteed to work well with domestic contractual transactions. Representatives of the business world expressed doubts such as whether the rules on hardship or fundamental breach are applicable to construction or credit contracts.

Thirdly, overly broad judicial freedom may lead to corruption, so less scope should exist for uncertainty created by concepts such as remoteness, hardship, and minor or fundamental breach.

While the author of this paper does not share these views, nonetheless this was the reaction from officials. To summarise, one can conclude that state institutions are unenthusiastic about reviewing the Civil Code. At

the same time, financing for wider research and development of drafts is not sufficient, although activity by academics is growing with new blood in the shape of new doctors of jurisprudence, Ph.D. candidates who have spent quite a long time exploring EU law and foreign practice.

Governmental institutions responsible for legislative procedure (ministries, the Cabinet of Ministers, and the State Chancellery) are quite reserved with respect to proposals based on the PECL, the UNIDROIT Principles, or other documents **without binding force** for internal relations. **Soft law** as a category of law has not gained recognition with national courts used to applying clear provisions of written law. In Latvia, where the rule of law as a priority is strongly declared, it is hard to accept the soft law concept, opening the door to considerable possibilities for different courts to resolve similar disputes differently, which causes rumours of corruption in the courts. One argument is that none of these authoritative documents is final and nobody can predict when, for example, the Common Frame of Reference will be completed.

## 4. View of the DCFR from the standpoint of Latvian law

With publication of the Draft Common Frame of Reference, within contract law and tort law the unification project has gained a certain degree of completeness. In any case, this document allows a comparison between the Civil Code and DCFR for purposes of finding solutions to problems highlighted during inventory of the Civil Code in the form of differences in the manner in which major questions are handled in the Latvian Civil Code and under prevailing concepts in EU law.

In this relation, let us examine some examples that have recently become the subject of debate.

1. Two options are available to resolve the issue of contract validity: in one case a party may avoid the contract (II.–7:201, 7:205, 7:207); in another, the contract is void (II.–7:301). Worthy of note, comparison shows that the DCFR contains additional grounds for invalidity besides mistake, fraud, and threats — i.e., unfair exploitation and, as a general rule, infringement of fundamental principles or mandatory rules. It remains to be seen whether the Civil Code's provisions on non-conformity with law and good faith are appropriate for the 'infringement of fundamental principles and mandatory rules' formula and contain 'unfair exploitation' criteria. The difference is that, according to the Civil Code, the contract is void in cases of mistake. A special novelty for Latvia will be the procedure for avoidance. No litigation for that will be necessary. Avoidance will be established by notice to the other party (II.–7:209). Another novelty will be the existence of two notice periods: (a) notice of avoidance is effective only if given within a reasonable time and (b) if a party entitled to avoid a contract confirms it, expressly or implicitly, then avoidance is excluded after the term of notice of avoidance begins.
2. Presumably positive could be provisions for adapting a contract in the case of a mistake (II.–7:203) and modification in particular circumstances, even if a contract infringes principles recognised as fundamental in the laws of EU member states (II.–7:302).
3. A new approach exists to issues of price in relation to all contracts (II.–9:104). Namely, where the amount of the price under a contract cannot be determined from the terms agreed upon by the parties, from any other applicable rule of law, or from usage or common practice, the price payable is the price normally charged in comparable circumstances at the time of signing the contract or, if no such price is available, a reasonable price.
4. Such an approach in Latvia is recognised only in relation to purchase agreements. In other cases, the purchase price must be expressly determined as an essential element of the contract. Failure to do so may invalidate the contract. Preference should be given to the solution proposed in the DCFR.
5. In relation to inadequate contract performance, it is expected that Latvia will provide for a wider range of possibilities for the party in default to carry out a cure. Article III.–3:202 expresses the following rules: if a debtor's performance does not conform to the terms regulating an obligation, the debtor may make a new and conforming tender if that can be done within the time allowed for performance, or promptly after being notified of lack of conformity.
6. A wider option exists also to foresee withholding of performance of a reciprocal obligation (III.–3:401) and many other elements unique to Latvian civil law.

At the same time, it must be noted that some provisions are controversial.

To understand the content of the DCFR, the definitions provided in its Annex I are of crucial importance or, as the Introduction states, "essential for the model rules". In this relation, several comments should be made, which follow.

Three terms used are interconnected and even overlap. These terms are ‘recklessness’, ‘negligence’, and ‘gross negligence’. A question arises as to whether the term ‘recklessness’ corresponds to the term ‘gross negligence’ or encompasses both forms of ‘negligence’. This question arises in relation to the definition of fundamental non-performance. Of course, it is possible to introduce four ‘degrees of guilt’: intent, recklessness, gross negligence, and slight negligence. But difficulties arise even with the distinction between gross and slight negligence. Problems will occur in relation to recklessness of legal persons. It seems that it would be enough if the DCFR included only ‘negligence’ and ‘gross negligence’.

The definition of gross negligence includes the expression ‘if a person is guilty’. This raises the question of the meaning of guilt or fault within the context of civil liability. In addition, the ‘self-evidently’ criterion is highly subjective. It would be truly revolutionary to waive the use of terms characterising degrees of guilt (fault) and turn to an objective evaluation of behaviour using the same terms as are still used in relation to negligence: if a person fails to meet the standard of care that could be reasonably expected (a) from a prudent person or (b) from a professional or otherwise if a higher standard is required. The PECL and other unification documents show a tendency to evaluate excuses of non-performance rather than fault.

The term ‘business’ so far has had several meanings, *viz.* to describe employment, occupation, profession, or entrepreneurial activity. Within the meaning of the DCFR, it is also used to describe a person who enters into an agreement. This could lead to the following confusing assertion: An enterprise conducts business in its place of business or outside it. It should be noted that the definition of a consumer contains the expression ‘not related to his business’ (as an activity), while the definition of franchise uses the expression ‘business method’. The term ‘business’ can be used to contra-distinguish one group of people or community from, for example, consumers. However, it cannot be used to describe an individual seller or a company. ‘B-to-B’ and ‘B-to-C’ are common terms used in everyday speech; however, they are not appropriate for use in statutory acts. Instead, terms such as ‘business person’, ‘merchant’, and ‘commercial entity’ should be used. The proposed wording would begin as follows: “‘business person’ means any natural or legal person acting [...]”.

The beginning of the definition of ownership shows strictly that ownership is an absolute right as opposed to a relative right. It is not necessary to say ‘most absolute’ because absolute is absolute. But, further on, the definition also contains the words ‘rights granted by the owner’; it is unclear what this means. Does it mean that besides the legal owner somebody else may be the owner? Or does it refer to the previous owner? This should be clarified by adding the wording ‘or restrictions (limitations) made by the owner’ or ‘rights granted to another person’.

The DCFR is called academic. For this reason, it should provide a complete structure of obligations (contractual and non-contractual) law, which would be of special importance for scholars and students. In reading the DCFR through, a question arises as to why some widely recognised types of contract are not included.

Of course, freedom of contract permits creation of new, as yet unknown, types of contract. Besides, each Member State has developed its own peculiar kinds of contract. Still, it is difficult to find reasons that well-known kinds of contract such as commission (consignation), apartment rental, civil law partnership, and others are left out of Book IV. The draft contains a remark that gift and loan contracts could be incorporated afterwards, and that special considerations affect transportation and insurance contracts. Studies of directive 2006/123/EC allow the remark that, although many fields are not covered by this and other directives on services, one cannot deny the existence of contracts for carriage of goods and passengers, insurance, sale of immovables, and other agreements.

The **proposal** is to declare reservations and name the specific types of contracts to be included in the DCFR in the future. Otherwise the impression could arise that some contracts are not recognised in the EU. Ignoring contracts of lending, contracts of carriage, and others creates the danger of categories of recognised and unrecognised contracts. This somewhat resembles the situation in ancient Rome, where recognised agreements (*contractus*) and non-recognised agreements (*pactum*) existed. Let us remember the origin of *pacta sunt servanda*. The reference in the DCFR that it does not cover the sale of immovables creates an incorrect perception that a contract for sale of immovables is not a civil contract. However, general provisions (e.g., on formation, validity, mistake, or fraud) and definition of sale also apply to it. A formula should be found to positively express that these contracts belong to the civil contracts category, even though their regulation has certain particularities.

Most contracts described in the DCFR are those in which no great divergences between Member States exist and they will probably not require introduction of any changes in national law. It could be more helpful to include those types of contracts that are still developing — for example, those pertaining to concession and package tourism. This would promote the DCFR truly becoming a handbook for national legislators.

As follows from Part C of Book IV, the group of ‘Contracts for Services’ would be a significant novelty for Latvia, and presumably also for Lithuania, Estonia, Germany, and a couple of other countries.

Part C contains General Provisions announcing, *inter alia*, that this group is to contain such types of contracts as construction, processing, design, and treatment contracts. This shows that the EU will give up the work-performance contract recognised in many states (see, for example, paragraph 631 of the German BGB on

*Werkvertrag*) and also regulated in the laws of Latvia, Lithuania, and Estonia. From one side, this could be justified by the provisions of article IV.C–2:106 that in all contracts covered by Part C a specific result must be achieved (emphasised as the relevant issue for contracts for work performance). From the other side, the question of definition of services and types of services remains open. Part C can be read in two ways. The first is that contracts for services are all encompassed in contracts itemised in Chapters 3–8 and since, consequently, all service contracts should be encompassed in one of these itemised contracts, no simple (general) contract for services exists. The second possible reading is that the starting point is a service contract, followed by subtypes or modified types of contracts, such as for construction, or design, with special designations of the party: constructor, processor, storer, designer (not service provider as in IV.C–1:101(1)). If this was intended, then a specific definition should be given for ‘service contracts’, one setting forth criteria via which service contracts can be distinguished from processing, storage, treatment, and other contracts. Currently, instead of criteria to be used for distinction, common general rules are provided (Chapter 2). The definition given is rather circular, as it fails to disclose the essence of both ‘supply of service’ and ‘service’.

The grouping of contracts in Book IV is not internally consistent with this. Only two groups are distinguished: Part C (Services) and Part E (Commercial Agency, Franchise, and Distributorship). The first group can be found to follow from the sphere of activity being regulated. The second group involves another distinction criterion — the area of commercial activity. This grouping could also be used in relation to other contracts. The Latvian Civil Code, for example, deals with the following groups: alienation contracts (including sales, barter, maintenance, and supply contracts), contracts requiring return of a thing (loan, lending, and bailment contracts), and contracts for management of another person’s affairs (mandate and commission contracts). Although such a grouping can be questioned, it is important that no general rules exist for each group. On the other hand, purchase contracts in the Latvian Civil Code are classed into subgroups containing the word ‘sale’ or ‘purchase’, such as ‘instalment purchase’, ‘repurchase’, and ‘sale by auction’. The various subgroups of the service group have their own names. They may, of course, be expanded to include the word ‘service’; for example, a contract for design may be called a contract for provision of design services. Nevertheless, the system seems not to be ideal.

It would be acceptable to find a new name, or several names (for example, maintenance or network service), for a contract that would encompass those agreements that do not fall under contract definitions for, e.g., construction, design, and processing (Chapters 3–8). This would not be called a service contract, because then it would contradict the terminology of EU directives where the term ‘service’ is used in a very broad meaning, as reflected by the title of Part C. So the matter remains open of what to call contracts for regulation of all contracts not encompassed by the six proposed groups of contracts. Directive 2006/123/EC declares what kinds of contract are not covered by that particular directive, among them electronic communications, audiovisual, and port services contracts. For these kinds of contracts, directives are expected to be drafted in the future. Although the directive does not deny that these are service activities, neither does it say that they must be regulated by a single kind of contract and that this necessarily must be a ‘service contract’ (for example, gambling does not fall under a service contract). It is simple to declare that a particular directive does not apply to certain things or activities, whereas the CFR as a toolbox cannot ignore that contracts are also used in these particular areas.

Probably more than one new kind of contract should be introduced — for example, a long-term service contract on joining a service network. This is recognised in Russia in relation to electrical supply (however, sale is dominant in this contract). In such contracts it would be appropriate to call one party the recipient (see article 4 of directive 2006/123/EC) and not the client. In other cases, the term ‘maintenance’ probably may be used safely.

In conclusion it should be emphasised that the Principles of European Contract Law and DCFR are already documents of considerable value. Published materials should be studied in universities, by legislative bodies, and also within law offices. It is good and right that the academic DCFR is still going to be improved and adjusted in light of various proposals up to the end of 2008. Nevertheless, it is clear that considerable time will pass before official EU institutions accept them in one or another form.