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CONDITIONS FOR APPLICATION OF CRIMINAL LIABILITY TO THE BOARD OF A COMPANY IN THE LEGAL SYSTEM OF THE REPUBLIC OF LATVIA

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Abstract. Criminal offenses in the area of commercial relationships, especially in recent years, pose a number of problems for public security and the efficient development of the economy. There is currently no common practice for identifying and qualifying them. Thus, there is a need to perform a detailed analysis of criminal offenses, committed during the management of capital companies, paying special attention to such aspects as the level of liability of a legal person, as well as the criminal liability of persons - management board members, for violations of law committed during the management of a legal person. In order to comply with the principles of international law regarding the criminal liability of legal persons and in order to harmonize legal norms, amendments to the Criminal Law of the Republic of Latvia were adopted. It gave a possibility to imply legal sanctions on legal entities. The adoption of these amendments strengthened the principles of equality, fairness and inevitability of punishment regarding to the criminal liability of legal persons.

Keywords: company, legal person, natural person, criminal liability.

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1. Doctrinal meaning of the concept of the board of a company

The process of defining the concept of the board of a company is closely related to the theoretical research of legal scientists, working in the field of social sciences. In the book “Handbook on the Formation, Management and Winding Up of Joint Stock Companies”, published in 1908, the authors F. Gors-Brown and V. Jordan viewed the board of the company as an executive body of the company, which is entitled to decide any issue, arising from the organization of the company, acting completely independently from the company’s shareholders (Gore-Browne, Jordan, 1908). The issue of defining the concept of a board of a company was also studied by L. C. B. Gower in his 1954 book “The Principles of Modern Company Law” (Gower, 1954), as well as F. B. Palmer in his 1949 book “Company Law: A Practical Handbook For Lawyers and Business Men” (Palmer, 1949), in which the board of the company was designated as the “board of directors”. In the seventies of the twentieth century, with the emergence and development of theories of effective management of the company, the United States began a gradual study of the effectiveness of the executive body of the company. In his 1973 book “European Commercial Law” (Goldman, 1973), B. Goldman focused on the concept of a company’s board of directors, focusing on the efficient management of the company’s performance while maximizing its profits. P. J. Sutton, T. W. Cousins in the book “Commercial Law” (Sutton, Cousins, 1971) define the concept of the board of a company as a guarantor of the company’s efficiency. At the end of the twentieth century, when the political and legal approach to defining the concept of a company’s board was mainly economic and psychological, the board was defined as a managing body, appointed by the company’s shareholders, whose performance is based on a certain ideology, but the main motive of the activity is to increase the profit of the company. Specific popularity achieved J. W. Smith’s book “A Compendium of Mercantile Law” (Smith, 1987), which declared the need for constant evaluation of the efficiency of the company’s board. At the same time, S. W. Gellerman defined the concept of the board of a company as a preacher of the company’s ethical values, which focused on the unwritten ethical and moral values of the company (Gellerman, 1986).

In the modern legal doctrine the understanding of the board of a company as an independent executive body, that organizes and manages processes within the company (Tumalavičius, Veikša, Načičionis, Zahars, Draskovic, 2017; Wang et al., 2021; Jiang et al, 2021), has strengthened its position. The understanding has expanded of possible mechanisms for improving the efficiency of the work of the board of the company, its techniques and methods of decision-making. P. A. Read, T. Portwood and A. Odeke defines the board of a company as a corporate governance body, that identifies business problems and solves them, trying to achieve the main aim of an efficient management (Read, Portwood, Odeke, 1992). A. Gibson and D. Fraser links the definition of a board of a company with a member of the board, posing on him special authorities, that are connected with organizing and directing performance of the company (Gibson, Fraser, 1997). D. Mills attributes the board of the company to the company’s main management bodies, offering to perceive the members of the board of the company as substitutes for the company’s shareholders and their representatives (Mills, 1995).

Representatives of the Latvian social sciences started to focus on the study of the concept of the board of a company at the end of the 1990s after the restoration of the country’s independence and after the unification of the Latvian legal system in accordance with democratic guidelines and EU law. Researcher V. Vilcāne defines the company’s board as an institution, that manages, represents, administers property of the private company, including money (Vilcāne, 2015). Lawyer U. Medne points out that the main task of a board member is to manage the company, make decisions, related to the company’s operations and its future development (Medne, 2016). Sworn advocate D. Rone points out that a member of the board of a company takes care of the welfare, prosperity, growth and order within the company (Rone, 2007). Sworn advocate I. Tillere-Tilnere believes, that the board of a company is the main executor of the company’s operational management, which is responsible for the company’s operations (Tillere-Tilnere, 2020). Sworn advocate T. Šulmanis points out, that the members of the board have rights to represent the company separately, each of the members of the board signs documents and concludes

transactions, that fall within his / her field of responsibility (Šulmanis, 2015). G. Šantare points out, that the company authorizes a member of the board to manage the company and to represent the company in relations with third parties within the limits of competence of the board, that is specified in the company's basic articles, as well as in the board members' decisions and company councils' decisions (*if such corporate body is functioning*) (Šantare, Šulmanis, 2019). On the other hand, H. Jauja, a specialist in commercial law, points out, that members of the board of a company must act as good and diligent representatives, otherwise inflicted losses to the company could be covered from the board (Jauja, 2017). E. Novicāne, a doctoral student at the Faculty of Law of the University of Latvia, in the publication "Duty of a board member to act in the interests of a company" defines the board of a company as an institution, that has a duty to act in a good faith and in the best interests of a company (Novicāne, 2019).

It should be noted, that there is no significant contradictions between all these ideas, regarding the notion of the board of a company, and in most cases authors grant specific rights to the company's board, that are connected mainly with rights to organize and manage the performance of a company. The existing definitions in the Latvian legal doctrine are similar and indicate the special legal status of the board of a company, its obligation to act in the best interests of the company and not to harm the company and its shareholders.

2. Basis for the application of criminal liability on the board of a company

The Convention of 26 July 1995 on the protection of the European Communities' financial interests clearly defines principles of the inevitability of liability of the board of directors of a company. In accordance with Article 3 of the Convention, each member state shall take the necessary measures to allow heads of businesses or any persons having power to take decisions or exercise control within a business to be declared criminally liable in accordance with the principles defined by its national law in cases of fraud affecting the European Community's financial interests, as referred to in Article 1, by a person under their authority acting on behalf of the business. According with Second Protocol of May 19th, 2009, of the Convention on protection of the European Communities' financial interests, that was drawn up on the basis of Article 3 of the Treaty on European Union, the conditions for determining the responsible persons were clarified.

In order to comply with the principles of international law regarding the criminal liability of legal persons and in order to harmonize legal norms, amendments to the Criminal Law of the Republic of Latvia were adopted on 5th May 2005, supplementing the law with Chapter VIII "Coercive Measures Applicable to Legal Entities". The adoption of these amendments strengthened the principles of equality, fairness and inevitability of punishment regarding to the criminal liability of legal persons (Zahars, Stivenieks, 2018). In addition, it is important to note, that the adoption of these amendments does not violate the principle of *non bis in idem* of Criminal Law, because the purpose of Criminal Law has achieved by applying punishment for the criminal acts of behaviour to the natural or legal person. Initially the idea of criminal liability of a legal person was not popular in Latvia. This idea was opposed by a number of legal professionals, resulting in a compromise and defining the criminal liability of a legal person as coercive measures applicable to legal persons. In this case it is possible to see an analogy with the application of coercive measures of upbringing to children and the application of coercive measures of a medical nature to limitedly dependent persons.

For example, on 5 April 2017, the European Court of Justice ruled in the decision ECLI: EU: C: 2017: 264, that Article 50 of the Charter of Fundamental Rights of the European Union must be interpreted as permitting an application of national legislation in the main proceedings, connected with failures to pay value added tax, after a final tax charge has been imposed on a legal entity and at the same time criminal proceedings were initiated against a natural person.

The main essence of the case: the applicants (Orsi and Baldetti), were prosecuted for VAT fraud, because they had not paid VAT within the time limits formulated by law. Criminal proceedings were initiated after the tax service authorities reported the offenses to the prosecutor. However, before the criminal proceedings were applied, the tax service authorities had calculated the amount of unpaid VAT and imposed an additional penalty on the company. The court sought a preliminary ruling on whether the prosecution of Orsi and Baldetti should have been terminated as a result of the *ne bis in idem* principle (Joined cases C-217/15 and C-350/15).

This decision of the court confirmed the principle of the parallel responsibility of a natural person and a legal person, that means, what the prosecution of one person does not preclude the possibility of prosecuting another person. Applying a criminal liability, the identification of the facts, the legal classification of the offense under national law and its nature must be carefully assessed. Those facts shall be assessed, taking into account the purpose of the provision, the applicants and the legal advantage of the application, as well as the nature and severity of the penalty (Decision of the Court of Justice of the European Union of March 20, 2018 *Menci*, ECLI:EU:C:2017:667).

The legal principle *ne bis in idem* is a fundamental principle of the human rights. Consequently, when applying the legal measures, it is the duty of the person, conducting the proceedings, to carefully assess whether there is no violation of the principle in his / her actions. According with the opinion of the authors, a formalized approach is not allowed in this case, as otherwise human rights and fundamental freedoms may be endangered.

Paragraphs one and three of the section 169 of the Commercial Law stipulate, that a member of the board must perform his or her duties as a prudent and diligent owner. A member of the board shall not be responsible for damages, if he proves, that he acted as a prudent and diligent owner. In practice this means, that the board member is responsible for everything, that occurs in the company, because he has to know everything (Jarkina, 2020).

In this occasion, the attention should be paid to the notion of „prudent and diligent owner”, which by its very nature implies a duty on the board member to control and supervise the employees and their actions. When assessing the criteria, specified in the article 18 of the Criminal Law Convention against Corruption of January 27, 1999, a member of the board is obliged to establish a logical and transparent crime prevention system in the company.

The liability of a member of the board for the inflicted consequences of his or her actions may take the form of civil and criminal case. In addition, the authors note the importance of administrative responsibility in determining the responsibility of board members. In addition to the civil and criminal liability, various alternative legal instruments are often applied to combat the offences of legal person and its board members. For example, in addition to criminal liability, European national legal systems have created an instrument of administrative liability (Ligeti, 2015).

For the form of criminal liability, it must be established the subjective and objective features of the offense, as well as the gravity of the offense, which should correspond to a specific composition of the criminal offense, provided in the Criminal Law of the Republic of Latvia. The purpose of applying the criminal liability of a member of the board of a company also differs (Lavrinovich, Lavrinenko, Jefimovs, 2012). The obligation to reimburse overdue tax payments, imposed on a member of the board of a company, has both a deterrent and a punitive feature of Criminal Law. At the same time the basis for the application of Civil liability for the illegal actions of the board is the acquisition of material satisfaction for the damage, inflicted to the company or its cooperation partner. The criminal liability of a board member may not only affect himself personally, but also have negative legal and financial consequences for the legal entity the board member represents (Matvejevs, 2018). Thus the shareholders of the company are negatively affected too (Jarkina, 2020).

The basis for the application of the criminal liability of a member of the board is closely related to the so-called the institute of application of coercive measures to the legal person. Thus, in accordance with Section 70¹ of the Criminal Law, a court or a prosecutor may apply a coercive measure to a legal person, including a state or local government company, as well as a partnership, for a criminal offense provided in the special part of the law. It is necessary to establish, what the offense was committed in the interests of a legal person, for the benefit of that person or as a result of its improper supervision or control, by a natural person, acting individually or as a member of a collegial institution of the legal person:

- 1) based on the right to represent or act on behalf of the legal person;
- 2) based on the right to take decisions on behalf of the legal person;
- 3) exercising a control functions within a legal person.

In order to impose any punitive measure on a legal person, it is necessary to establish a legal link between the legal person and the natural person, who has committed the criminal offense. If such a link is not established, there will be no basis for imposing any coercive measure on the legal person (Rozenbergs, Strada-Rozenberga, 2018).

At the same time, the Criminal Law does not distinguish such a special subject of criminal liability as a member of the board of a company (Kriviņš, 2015). Taking into account the features of application of punitive measures to a legal person, referred in the Section 70¹ of the Criminal Law, the application of criminal liability on a member of the board of a company shall be based on the following features:

- committing an offense in the interests of the company and for its benefit or committing an offense in its own (board) interests;
- inadequate supervision and control of the processes in the company by the board and the company's shareholders has been established;
- the board abuses the trust of the shareholders of the company by handling their property (here the company is meant) within the assigned competence or by violating the limits of its competence;
- the activities of the board of a company are performed covertly from the shareholders and without their consent.

The establishment of such features allows the application of a punitive measure to a legal person, while the board of a company - natural persons - is subject to the criminal penalty provided in the Criminal Law.

3. Forms of criminal liability of the board of a company

Legal practitioners are reducing their focus increasingly on the responsibilities of senior management, including members of the company's board of directors. Legal mechanisms are being developed to combat economic and financial crime in a uniform, rational and effective manner.

The sustainable development of the country could be achieved by introducing the principle of inevitability of responsibility into the legal system and introducing clear and transparent legal instruments.

Each country incorporates individual and strategically important measures to combat financial crime, taking into account the genesis of the law and the common legal awareness of the society. Undoubtedly, when evaluating the experience of other countries, it is possible to see the common position of the countries and the similarity in the application of legal norms and creation of legal institutes.

In the Latvian legal system, the basis for the application of criminal liability to the members of the board of a company as natural persons is presumed in the Section 12 of the Criminal Law. The liability of a natural person as a representative of a legal person is established by presuming, that a criminal offense is committed in the interests of a legal entity under private law, for the benefit of that person or as a result of its improper supervision or control. In other words the liability of a natural person as a representative of a legal entity arises both as a result of an act or an omission, if it is proved in the case, that the person's duties were connected with supervising or controlling a legal entity.

Thus, for example, in the decision of the Senate of the Republic of Latvia on September 21, 2021 (Case no.11816006415), the Senate stated, that the appellate court had stipulated what the accused had not deliberately committed the violation of copyrights, as well as the accused didn't understand the harmfulness of his conduct and didn't intend to cause any harmful consequences. Consequently the Senate hasn't assessed the circumstances, established in the case and hasn't applied Section 12 of the Criminal Law, which regulates the liability of a natural person in the case of a violation of the interests of legal entity. The main task of a member of the board of the company is to manage and represent the company. This means that a member of the board has a certain set of rights and obligations, that he has to assume in order to ensure the activities of the company. An individual natural person (CEO, chairman or other responsible employee) or a group of natural persons (board, council, etc.) have to act on behalf of a legal entity. In order to bring an action against a member of the management board, who manages a legal entity, it is sufficient that an improper control of the company by the member of the management board is established. In this case, it is necessary to speak of the legal scope of the concept of „prudent and diligent owner”.

The Supreme Court in the case No.11816015611 (SKK-311/2016) on 23 November 2016 has strengthened the legal link between the act or omission of the responsible natural person and the actual activities of the legal entity. The court has established, that contrary to the provisions of Section 12 of the Criminal Law, the appellate court has made a conclusion, that a natural person may be held criminally liable only, if he or she has acted individually. The appellate court has not assessed, what is indicated in the indictment against /I.S./, that he acted as a responsible official of the legal entity. That means, what in accordance with Article 12 of the Criminal Law he could perform his illegal acts in a form of actual acts or omission. Thus, the appellate court has incorrectly applied Section 12 and Section 148, paragraph three of the Criminal Law. As a result the indictment did not indicate the features of the composition of the criminal offense, provided in the Section 148, paragraph three of the Criminal Law. Such a ruling shall not be recognized as lawful and justified within the meaning of Section 511, paragraph two of the Criminal Procedure Law.

Article 70⁶ of the Criminal Law stipulates that a court or, in the cases provided by law, a prosecutor may apply a coercive measure to a legal entity, including a state or local government company, as well as a partnership, for a criminal offense provided in a special part of this Law. It is necessary to establish, that the offense was committed in the interests of a legal entity, as well as for the benefit of that person or as a result of its improper supervision or control, by a natural person acting individually or as a member of a collegial institution of that legal entity. That means, what in each individual case, both the legal entity and the natural person, who committed the offense in the interests of the legal entity, for the benefit of that person or as a result of its improper supervision or control, will be identified. And only in the presence of such conditions is it possible to apply a coercive measure to a legal person. Exceptional cases are stipulated in the Section 439, paragraph three of the Criminal Procedure Law. It stipulates, that the person, conducting the proceedings, may separate the proceedings regarding the application of a coercive measure to a legal person in a separate case by a decision, if:

- 1) criminal proceedings against a natural person are terminated on the basis of non-rehabilitative circumstances;

- 2) circumstances have been established which prevent the identification or prosecution of a specific natural person, or, for objective reasons, it is not possible to bring the criminal case to court in the near future (within a reasonable time);
- 3) to resolve in a timely manner the criminal proceeding with the natural person, who has the right on defense;
- 4) this is requested by the representative of the legal entity.

Coercive measures such as liquidation, restriction of rights, confiscation of property, recovery of money may be imposed on a legal person. Court decisions impose either one or more coercive measures. No other coercive measures are imposed in the case of liquidation.

Members of the board of a company as natural persons are punished in accordance with the provisions of the special part of the Criminal Law. The members of the board of a capital company may be subject to criminal penalties such as deprivation of liberty or temporary incarceration, forced labor or fine, with or without confiscation of property, probation supervision, deprivation of the right to conduct specific or all type of commercial activities or deprivation of the right to conduct a certain occupation or the right to hold a certain position.

Undoubtedly, when evaluating the legal mechanisms of Latvia in the term of the criminal liability of the board of a company, it is important to compare and analyze the connections between the experience of other countries regarding this issue.

For example, the Finland Criminal Code sets out the liability of a natural person acting on behalf of a legal person in the Chapter 5, Section 8. Contrary to the provisions of the Criminal Code, the Finnish legal regulation separately distinguishes the group of persons, who may be held liable acting on behalf of a legal person. These persons include members of the management of a company, as well as persons, who is entitled with decision-making power in the company or who otherwise acting on its behalf. In the Finnish criminal law, similar to the provisions of Latvian criminal law, the liability of a legal person does not replace the individual criminal liability of a natural person. That means, what one form of liability does not preclude the application of another form of liability.

In the decision of the Supreme Court of Finland KKO 2016: 58 the court assessed the liability of the head of a company for inflicted environmental damage. The court in the judgment assessed whether the members of the board could be held liable for the degradation of the environment. The court concluded, that the ignorance of two members of the board, who didn't read the content of the environmental permit, is considered as a negligence, therefore the members of the board should be held liable. This means, that the members of the board are liable not only for intentional and deliberate action, but also for failure to act, because these responsibilities are included in the supervisory function of the company board.

Article 121-2 of the French Penal Code establishes the form of criminal liability of a legal person. Code stipulates, that the criminal liability of a legal person does not exclude the criminal liability of a natural person, who performs the same activity and therefore is considered to be the subject of the Article 121-3 of the French Penal Code.

In order to fight corruption and promote fair business in France, Law no. 2016-1691, known as „Sapin II”, passed on 9 December 2016. The law came into force on June 1, 2017. For example, Article 17 of the law requires companies and groups of companies with a parent company in France, as well as public industrial and commercial establishments with at least 500 employees and a turnover of more than EUR 100 million, to take measures to prevent any cases of corruption. Law no. 2016-1691 (in accordance with Article 41-1-2) established a procedure,

that allows any legal entity, accused of corruption, trading of influence, money laundering, tax fraud, to make a plea deal with the Prosecutor's Office in exchange for termination of the proceedings. The agreement is based on the conditions set by the Prosecutor's Office, which the legal entity have to comply with. However, it is important to note, that such an agreement does not relieve the company's board of directors of liability and that members of the company's board as natural persons could be the subject to sanctions.

The principle of the inevitability of liability of legal entity in the case of a merger with another company, was confirmed by a ruling of the French Chamber of Criminal Cases of the French Supreme Court (*Chambre criminelle de la Cour de cassation*) of 25 November 2020. The decision excluded the possibility of companies, violating the law and deliberately liquidating or merging, to avoid any liability.

In the Dutch legal system, the legal liability of members of a company's board is included in the Article 51 of the Dutch Criminal Code, which sets out the liability of both the legal person and the person, who committed or directed the offense. It is also important to note, that the article states that the criminal liability of the members of the company's board may also be considered as a criminal offense, committed in a group of individuals. The Dutch Criminal Code and the Dutch Economic Offences Act allow legal persons and natural persons, as representatives of a legal person, to be subject to criminal sanctions for criminal offenses.

The liability of a natural person as a representative of a legal person is enlisted in the case-law, which stipulates, that liability applies if a person fails to take measures to prevent a criminal offense (*The Dutch Supreme Court's decision of 26 April 2016, ECLI:NL:HR:2016:733*). Participation shall apply in cases, where two or more natural and / or legal persons jointly commit an offence, this cooperation between participants is intentional and deliberate, and it is possible to establish a significant contribution of the participants to the outcome of an offense (*The Dutch Supreme Court 2 December 2014, ECLI:NL:HR:2014:3474*).

4. Conclusion

As a result of the analysis, performed within the framework of the research, it can be concluded, that the management of the company is subject to a rather complicated regulation, violations of which are common in the legal entities of Latvia. The most serious violations in this area are criminal offenses, which require a high level of professionalism and qualification not only in their identification, but also in their qualification and application of liability. Very often the criminal liability of a natural person - a member of the Board - was applied simultaneously with the coercive measures, applied to legal persons within the framework of criminal proceedings and the penalties imposed by the State Revenue Service. In that situation it is important to avoid violating the legal principle of "ne bi in idem", which the authors are actively discussing in this article. Taking into account Latvia's limited experience in this field, the authors use the case law of foreign and European Union legal institutions, especially in matters, that are relevant to the activities of Latvian law enforcement institutions. Within the framework of the article the authors sought to identify the boundaries between different types of violations of law in order to prevent unjustified violations of human rights and the interests of shareholders of companies by imposing state coercive measures.

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