

## JUSTIFICATION OF THE ABOLISHMENT OF LOCAL GOVERNMENTS REAL ESTATE RIGHT OF FIRST REFUSAL IN LATVIA

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**Abstract.** Procedure of offering and exercising right of first refusal on immovable property differs in countries across the globe. Right of first refusal bestowed on local governments by the law is the most controversial one with extreme opinions on both sides — some believe that local governments need extensive opportunities to exercise right of first refusal, while others, quite to the opposite, think that the local governments should not hold such rights at all. If the local governments have free hands to exercise the right of first refusal on real estate, it should be considered as an administrative hindrance impeding transactions with real estate. It is evidenced, for instance, by Doing Business' criterion Registering Property, according to which it takes five days to receive a rejection of right of first refusal in order to register the property rights in Latvia. There is an opinion that local governments exercise their right of first refusal in rare cases. To examine that hypothesis, data were obtained from local governments in Latvia regarding the number of cases when the right of first refusal was exercised between 2015 and 2017. The final part of the study offers a solution to the adverse consequences caused by efforts to bypass statutory right of first refusal given to local governments.

**Key words:** right of first refusal, right of pre-emption, real estate transactions.

**JEL code:** R3, K11, K25.

### Introduction

Right of first refusal is a right established by law, contract or will to first the refusal rights holder to acquire a property on the conditions agreed upon in a completed transaction between seller and buyer (Zevenbergen et al., 2007) or to be entitled to 'step into the shoes of the third party' upon the conclusion of a contract (Naude, 2004). An advantage to acquire a property after another has turned down this right is widely used in a number of different contexts (Naude, 2006). Usually similar terms are used to designate such right – 1) 'right of first refusal', defined by Black's Law Dictionary as „a potential buyer's contractual right to meet the terms of a third party's offer if the seller intends to accept that offer" and 2) 'pre-emptive right' or 'right of pre-emption' – „a potential buyer's contractual right to have the first opportunity to buy, at a specified price, if the seller chooses to sell". Therefore, some English writers limit the term 'right of pre-emption' to preferential rights to purchase at a fixed price (Naude, 2006). However, the scientific literature does not follow a certain pattern of terminology consistently. Commonly, both terms are used to indicate one's right to acquire a property under the same conditions.

In Europe the picture of the right of first refusal law and procedures in this regard is very diverse (Schmidt et al., 2005). Several scientists have tried to systematise and compare first refusal rights in different countries (Schmidt et al., 2005; Zevenbergen et al., 2007). Every country has its specific types and subjects of the right of first refusal as well as procedure of offering and use thereof. In some countries right of first refusal does not exist (Italy and Netherlands) or it is limited (Spain, Sweden and Scotland) (Schmid et al., 2005), and there are also countries, Latvia among them, with a wide range of persons entitled to the right of first refusal and a complicated procedure of the offering and exercising of this right.

One of most frequently named examples of local governments exercising limited right of first refusal is, for example, in Slovenia - within the defined area in Slovenia the local government can, according to the law, establish the right of first refusal on the desired areas which may be comprised of one or more plots or even a whole territory of the local government (Zevenbergen et al., 2007). In some cases, not only does a buyer hold the right of first refusal, but, for example, in France, the

Land development and rural establishment society (*Societes d'Amenagement Foncier et d'Etablissement Rural*) is entitled to replace the receiver of donation in case of certain types of donation receivers. Usually the right of first refusal is defined as an integral part of land management and is contractual or legal — for local government, state, tenants and lessees, joint owners, neighbours etc.

When it comes to the right of first refusal, several important questions arise, for example — which types of transactions are covered by a right of first refusal agreement? What is the effect of a sale of the right of first refusal property as part of a larger package of properties? (Naude, 2006). Nevertheless, the goal of this research is to find out if local governments in Latvia really need to have the right of first refusal. Therefore, in the beginning it was analysed the regulatory framework of all first refusal rights in Latvia. Secondly it was determined the frequency of the use of the right of first refusal by local governments by sending surveys to all local governments in Latvia and summing up the results. Then it was concluded that, apart from a small number of cases when the right of first refusal was actually used by local governments, bypassing the right of first refusal is a very common practice in Latvia. Finally, at the end several proposals are put forth to potentially solve the adverse consequences of the local government real estate right of first refusal.

### **Types of right of first refusal of real estate in Latvia**

Latvia has a complicated, multi-level procedure for exercising the right of first refusal based on: 1) a law; 2) an agreement (mandatory corroboration of agreed right of first refusal in the Land Register); 3) a court judgement; 4) a will. In 2018, the right of first refusal in Latvia was stipulated in 18 laws (this number tends to increase) and the procedure for the implementation of this right is laid down in five regulations of the Cabinet of Minister of LR. The right of first refusal in Latvia must be offered to:

- 1) joint owners (cannot exercise right of first refusal only where the undivided share is sold to another joint owner);
- 2) in some cases, to heirs of real property;
- 3) in case of partial ownership to land and structures to owners of the structure or land;
- 4) local governments:
  - if real estate in the local government administrative territory is being alienated and such is necessary to perform the local government functions prescribed by law, by taking into account the use of the territory permitted (planned) in the territorial planning, laws and regulations, development planning documents and other documents that substantiate the necessity of the relevant real estate for the implementation of the local government functions (Law „On Local Governments”);
  - in port territories — to local government port administration;
  - in territories of national civil aviation airfields;
- 5) the State:
  - in especially protected natural zones;
  - when alienating a national cultural monument;
  - if the real estate being sold is located in the territory of a national civil aviation airfield;
  - if private person owns land at public waters and want to sell it.
- 6) the Latvian Land Fund, if agricultural land is being sold.

- 7) apartment owners when selling the apartment property, if the community of apartment owners has decided thereon and an entry has been made in the Land Register regarding the existence of the right of first refusal.
- 8) special economic zone administrations if a transaction with real estate takes place in its territory.
- 9) power utility companies regarding objects used for supplying power, including buildings, structures, systems, devices, equipment, networks, pipelines or other objects that are not a property of the power supply company, yet it is included in the balance sheet of the merchant or is situated in the area of operation of licence of the power supply merchant in question.

### **Right of first refusal of local governments as an obstacle hindering real estate transactions**

Of all the types of right of first refusal, those given to local governments is the most controversial, as it significantly hinders real estate transactions and constitutes an excessively burdening formality in real estate transactions (Svemberga, 2012). Latvian local governments have right of first refusal on transactions of real estate, except where 1) real estate is acquired by the State; 2) real estate is acquired by foreign states for the needs of their diplomatic or consular institutions; 3) property to be privatised by the State and local governments; 4) production facilities with all their equipment; 5) real estate that is transferred from one person to another without remuneration or by way of exchange; 6) real estate from which a part has been alienated and which property remains under joint ownership of the seller and purchaser; 7) real estate that is being sold by voluntary or mandatory auction; 8) real estate in relation to which third persons have the right of first refusal based on law, contract, or will; 9) residential property, including a flat, the ownership of which has been acquired up to the privatisation of the residential building (On Local Governments, 1994). In all other cases of acquiring real estate the local governments must be offered right of first refusal. It has become a formal procedure and the prescribed term, most often, is merely a factor burdening the transaction, because in most cases one can see from actual circumstances that the property subject to transaction will not qualify for functions of local government (Svemberga, 2012).

Several authors have sought ways to restrict or reduce these mostly formal „supervisory“ entitlements of local governments (Goehner, 2006; Svemberga, 2012): 1) registering a note about possible right of first refusal by local governments for those properties that are required by the local government to implement its functions (in the Netherlands - designate an area within which a landowner who wants to sell his property is obliged to offer it first to the local government (Buitelaar, 2010; Ploeger et al., 2005)); 2) declining the right of first refusal of local governments. Declining the right of first refusal of local governments as the main conclusion in his doctoral thesis „Right of First Refusal of Local governments“ is put forth by, for example, an expert of German administrative law Torsten Goehner.

Local governments rarely exercise their right of first refusal, for example, in Germany (Goehner, 2006). In 1999, 3,200 cases out of 44,600 purchase transactions had right of first refusal in 116 local governments of Germany where they were exercised 47 times, hence in ~0.11 % of all acquisition transactions of real estate in these local governments.

Table 1

**Number of cases when Latvian local governments have exercised the right of first refusal on real estate between 1 January 2015 and 31 December 2017**

No	Local government	Type of notification	2015	2016	2017	Total (each local governments)
1	Rezekne city	e-doc	6	2	8	16
2	Jelgava city	e-mail	0	3	3	6
3	Kekava county	e-doc	1	4	1	6
4	Marupe county	e-doc	2	2	1	5
5	Valka county	e-doc	1	2	1	4
6	Aluksne county	e-mail	0	1	2	3
7	Cesis county	e-mail	0	2	1	3
8	Daugavpils city	e-mail	0	2	1	3
9	Jekabpils city	e-mail	0	2	1	3
10	Riga city	e-doc	1	1	1	3
11	Grobina county	e-mail	2	0	0	2
12	Jurmala city	e-mail	1	1	0	2
13	Kraslava county	e-doc	0	2	0	2
14	Babite county	e-mail	0	0	1	1
15	Balvi county	e-mail	0	1	0	1
16	Burtnieki county	e-mail	0	1	0	1
17	Dobele county	e-doc	1	0	0	1
18	Durbe county	e-doc	0	0	1	1
19	Gulbene county	e-mail	0	0	1	1
20	Jelgava county	e-doc	1	0	0	1
21	Koceni county	e-doc	1	0	0	1
22	Krimulda county	e-doc	1	0	0	1
23	Liepaja city	e-doc	0	0	1	1
24	Limbazi county	e-mail	1	0	0	1
25	Ogre county	e-doc	1	0	0	1
26	Ozolnieki county	e-mail	1	0	0	1
27	Rezekne county	e-doc	0	0	1	1
28	Ropazi county	e-doc	0	0	1	1
29	Saldus county	e-mail	0	1	0	1
30	Stopiņi county	e-doc	0	0	1	1
31	Valmiera city	e-mail	1	0	0	1
32	Viesīte county	e-mail	1	0	0	1
<b>Total</b>			23	27	27	

Source: author's calculations based on data received from local governments

**Conception of the Cabinet of Ministers of the Republic of Latvia „On Simplification of Procedures of Corroboration of Real Estate Rights” in 2009** states that the local government exercises the right of first refusal „extremely seldom”. In order to find out the extent to which the local governments exercise the right of first refusal in Latvia, in February 2018, a survey requesting an answer to the question: „how many times has your local government exercised the right of first refusal in years 2015, 2016 and 2017” were sent to all 119 local governments in Latvia (9 cities and

110 counties of the Republic). One hundred two local governments replied to the letter sent in February 2018, but two of them (Salaspils and Sigulda countries) did not provide an answer as to the merits, they were inaccurate and were found not to qualify for the research. Surveys were sent to the remaining 17 local governments in April 2018. After repeatedly sending the survey, answers were received from 112 local governments totally representing 96.4 % of the territory of Latvia. (The Baldone, Baltinava, Dagda, Jaunpiebalga and Varaklani local governments did not reply, however they constitute a very small portion of the territory of Latvia),

It can be concluded from the answers received from the local governments that the right of first refusal was used by local governments less than 30 times per year (in ~0.5 % of cases of all real estate transaction purchases) between 2015 and 2017. Only 32 local governments (Table 1) have exercised their right of first refusal on real estate purchases at least one time during said period. Many local governments, when answering the question, also explained that they have never exercised the right of first refusal.

The following conclusions can be drawn regarding the right of first refusal of local governments:

- 1) local governments exercise right of first refusal on real estate purchase transactions in very rare cases;
- 2) in the survey comments, local governments emphasized that they lack funds to use the right of first refusal, even if a particular real estate would be required for implementing the functions of local governments. A similar conclusion was drawn also in Germany (Gohner, 2006);
- 3) some of these transactions are 'negotiated', namely the local government and most often a land owner makes an agreement that if the property is sold at certain purchase price, it is agreed in advance that the local government would use the right of first refusal. Such transactions exist even though it is impossible or very difficult to identify them if the parties do not admit it;
- 4) employees of the local governments believe that right of first refusal are introduced to implement municipal functions, they are laid down in the law and hence they are legally grounded and necessary. One can see that the employees of local governments find it self-evident and important to 'supervise', control transactions, and to know what real estate transactions are made in the territory of local government;
- 5) employees of several local governments were of the opinion that right of first refusal of local governments does not impede real estate transactions. For example -

Opinion of the representative of Priekuli county: „We cannot agree with the opinion that the right of first refusal impedes transactions“;

Opinion of the representative of Engure county: „I cannot agree with You, that local governments could be an impeding factor. Local governments can exercise the right of first refusal only if this property is required for implementation of functions of the local governments and complies with the planning documents“;

Opinion of the representative of Garkalne county: „Right of first refusal does not allow local governments to acquire the property without any restrictions only because it has an advantageous location or a low price. Following from this consideration, we would like to point out that we find the opinion about impeding impact of the right of first refusal of local governments on real estate transactions to be biased“;

Opinion of the representative of Dobeles county: „We cannot agree with the thesis presented in the survey that the use of right of first refusal of local governments qualifies as one of potential impeding conditions of real estate acquisition transactions in Latvia. The following is the rationale

behind our objections: 1) after restoration of land ownership rights the former owners were not always willing to receive land in other location as compensation for former land property. Hence, there are real cases where municipal buildings (1 school, 2 preschool establishments in Dobele) are situated on a land owned by private persons. If said land plots were sold, the local government would certainly want to exercise the right of first refusal to end the situation of joint ownership; 2) Applications on use of right of first refusal are examined by the local government in 5 work days maximum therefore it cannot be considered as an essential impediment; 3) Commercial objects are never subject to the right of first refusal of local governments".

Dr. iur. A. Svemberga found the right of first refusal of local governments as an excessively encumbering formality in transactions with real estate and this was acknowledged also by the Cabinet of Ministers of the Republic of Latvia, stating that „procedure of right of first refusal of the State and local governments, given its mandatory nature, involves essential complications and prolonged periods for corroboration of real estate ownership rights in general; the right of first refusal process (in the preparation stage) rather considerably prolongs the registration process both in terms of the steps and time required and time-consumption"). Therefore, to believe that the right of first refusal of local governments does not impede transactions is to neglect the fact that they hinder transactions. It must be acknowledged that the delay is relatively short (pursuant to Regulations No 919 of the Cabinet of Ministers of 28 September 2010 „Regulations on Procedure and Terms of Use of Right of First Refusal by Local Governments" — 20 days; In calculations of Doing Business' principle Registering Property the right of first refusal assigned to the local governments in Latvia is valid for five days; in practice the period to decline is usually estimated between 15 minutes and five days), but considering the large number of rejections, this delay is disproportionate and unnecessary, because the State has established a mechanism for functions of local governments regarding alienation of real estate required for their functions — these are rights to address the Cabinet of Minister with a proposal to alienate real estate as stipulated in the law in favour of certain local government, if this property is necessary for public use (public needs), i.e. construction of roads, streets, squares, pedestrian walks, scaffold bridges, flyovers, as well as port berth. It means that the local governments have an instrument for alienating the real estate to ensure functions of local governments — to alienate the property for public needs (compulsory acquisition), and they do not need to 'control' or 'supervise' all real estate purchase transactions (except those stipulated in the Law On Local Governments).

The main shortcoming of such 'supervision' or right of first refusal as 'means of threat' (German *Drohmittel* (Gohner, 2006)) used by a local government is a wish of the parties to 'bypass' right of first refusal given to the local governments. Existence of such transactions has been admitted in market price reports also in Latvia between 2006 and 2007, although today the situation is virtually the same: „[...] such practice has been created, because the parties involved in a purchase transaction want to bypass the statutory right of first refusal given to the local government, by selling the property in undivided shares. In approximately half of the cases the property is sold in undivided shares (usually in two transactions). The most common proportions are 1/2 and 1/2, 1/10 and 9/10, 1/100 and 99/100, 1/3 and 2/3" (Real estate market report 2012 Q4. Agriculture and forest land market). Between January 2006 and April 2007, purchase contracts were repeated within five days, and it means that the right of first refusal given to the local governments or the State to one and the same property in 25.9 % of cases among all purchase agreements in total (Conception project „On Simplification of Corroboration of Real Estate Rights") was bypassed, which evidences an extremely

intense bypassing of the right of first refusal, in addition to bypassing the right of first refusal when concluding a fictitious barter contract or donation contract. If the parties avoid the right of first refusal, eventually it leads to the following adverse consequences (shortcomings) in the land management system in the State in general:

- 1) inaccurate records of transactions;
- 2) false purchase price specified in purchase contracts;
- 3) waste of unreasonably large amount of administrative resources of local governments (Goehner, 2006);
- 4) distrust in civil rights, wish to 'bypass' them, hide actual data of transactions;
- 5) encouragement to parties to enter in risky transactions without being aware of their negative implications, resulting in a situation where one of contractual parties (usually households) find themselves in a less competent position, leading to considerable loss in future. For example, Section 1415 of the Civil Law of the Republic of Latvia states „an impermissible or indecent action, the purpose of which is contrary to religion, laws or moral principles, or which is intended to circumvent the law, may not be the subject-matter of a lawful transaction; such a transaction is void”. So, if a transaction is intended to 'bypass the law' (right of first refusal of local governments), it may be declared void.

These shortcomings in land management in general constitute more extensive loss in comparison to the right of first refusal of local governments used slightly less than 30 times within one year.

Recently in Latvia one can see efforts to improve the process of use of right of first refusal of local governments. Decree No. 125 of the Cabinet of Ministers of LR of 15 May 2017 „On Plan to Improve Entrepreneurship Environment” it was intended: „...to ensure electronic data exchange among local governments and Land Register in area of using the right of first refusal by cancelling the mandatory requirement for residents to receive a reference issued by the local government and to submit it in the Land Register”. Such amendments would lead only to considerable change in terms of time of implementing the transaction and overcoming administrative hindrances related to that real estate, however it would not abolish the right of first refusal of local governments as such, but would merely facilitate information exchange procedure.

### **Conclusions, proposals, recommendations**

Basing on the data obtained and arguments analysed, the authors recommend:

- 1) to abolish the right of first refusal of local governments in the case of selling real estate or
- 2) to entitle local governments to right of first refusal only in certain areas included in the development plans of the local governments, if a simple, publicly available (to transaction parties, local governments, notaries, Land Registers) and easy to implement way is found to identify such areas without registering relevant remark in the Land Register that would constitute a restriction of those property rights.

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