

A BRIEF OVERVIEW OF GEORGIAN COMMERCIAL LAW

DISPUTE RESOLUTION MECHANISMS

INDEPENDENT NATURE OF DEMAND GUARANTEES



ნოდია, ურუმაშვილი და პარტნიორები
NODIA, URUMASHVILI & PARTNERS
B U S I N E S S L A W F I R M

Summary



❑ **A Brief Overview of Georgian Commercial Law**

- Legal system
- Sources of law
- Local commercial laws
- International conventions

❑ **Dispute Resolution Mechanisms**

- Georgian courts
- Arbitration
- Mediation
- DB

❑ **Guarantees**

- Types of the guarantees under Georgian law
- Independent nature of the demand guarantees
- Case law



A Brief Overview of Georgian Commercial Law

Legal System



□ Civil law jurisdiction

▪ **Codified Statutes**

- Codes and other laws (statutes) enacted by the Parliament of Georgia.
- Regulations, orders, and other by-laws.

- Georgian courts apply and interpret *the laws created by the legislators* to decide a particular case.

▪ **Case law**

- Decisions of the upper courts - non-binding on lower courts.
- Highly respected and followed as recommendations.

Sources of Law in Georgia



Constitution



International
Agreements



Organic Law



The Civil Code
Other Laws



regulations
orders
other by-laws



Commercial Laws of Georgia



- ❑ Civil Code of Georgia
- ❑ Other laws, regulations, orders, and by-laws.
- ❑ International Agreements / Conventions

The Civil Code of Georgia (CCG)



□ Civil Code of Georgia, inter alia, covers:

- Law of Obligations
- Contract Law
- Tort Law
- Property Law

□ Freedom of Contract

Freedom of Contract



Freedom to enter into agreement and freedom to determine its content

- ❑ Agreement shall **not**
 - contravene the rules and prohibitions established by the law
 - be against public policy
 - be against moral norms

- ❑ Be aware of **IMPERATIVE** provisions of the law:
 - Can not be altered
 - Can not be contracted out

Other notable laws



- ❑ Law of Georgia on **Entrepreneurs**
- ❑ Law of Georgia on **Commercial Banks**
- ❑ Law of Georgia on **Securities**
- ❑ Law of Georgia on **Copyright / Trademarks / Patents**
- ❑ Law of Georgia on **Public-Private Partnerships**

Notable International Conventions



- ❑ United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) (the “**CISG**”)
- ❑ Convention on the Contract for the International Carriage of Goods by Road (Geneva, 1956) (the “**CMR**”)
- ❑ United Nations Convention on the Carriage of Goods by Sea (Hamburg, 1978) (the “**Hamburg Rules**”)
- ❑ Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (the “**New York Convention**”)
- ❑ Berne Convention for the Protection of Literary and Artistic Works (Berne, 1886) (the “**Berne Convention**”)



Dispute Resolution Mechanisms

Georgian Courts



❑ **Three Instances**

- City Courts
- Court of Appeal
- The Supreme Court

❑ **Resolution of civil matters**

- Adversarial procedures
- The role of the judge
 - prepares and manages the process
 - instructs the parties to perform certain activities, present documents, etc.

Alternative Dispute Resolution



❑ Arbitration

- Based on the UNCITRAL model law
- The New York Convention

❑ Mediation

- Mandatory
- Optional

❑ DB – dispute boards

- Introduced in FIDIC Contracts



Guarantees

The Types of the Guarantees/Instruments



❑ **Surety** (CCG, Art. 891)

- Secondary obligation
- Accessory to the underlying agreement

❑ **A Bank Guarantee** (CCG, Art. 879)

- “Under the bank guarantee **a bank, other credit institution or an insurance company** (the “Guarantor”) assumes a written undertaking at the request of the third party (the “Principal”) to make the payment to the creditor of the principal (the “Beneficiary”) on the basis of the written demand of the Beneficiary.”

❑ **A Letter of Credit** (CCG, Art. 876)

- The **credit institution (issuing bank)**, at the request of the client, shall make **the payment upon presentation of the documents** listed in the letter of credit.

A Bank Guarantee



❑ **An Independent obligation** (CCG, Art. 881)

- “The Guarantor’s obligation to the beneficiary **is independent of the primary obligation of the principal** even if the guarantee contains a reference to such obligation.”

❑ **The form of a demand** (CCG, Art. 885)

- 1) the written form (including the electronic form in certain cases)
- 2) accompanied with the documents listed in the guarantee.

A Bank Guarantee



❑ **Duties of the Guarantor (CCG, Art. 886)**

- Inform the principal, and
- Check the compliance of the demand and the presented documents with the conditions of the guarantee.

❑ **Grounds for refusal (CCG, Art. 887)**

- The demand or the presented document does not comply with the conditions of the guarantee.
- The term of the guarantee has expired.

Independent Nature of Bank Guarantees

Case № as-781-996-08 [2009]



□ *The Parties*

- The Beneficiary – the department of the Ministry of Economy (Claimant)
- The Guarantor – an insurance company (Respondent)

□ *The Facts*

- **A performance guarantee.**
 - **The underlying agreement:** an agreement on the maintenance of the roads.
 - **The underlying agreement was terminated** by the beneficiary due to the principal's failure to fulfill its obligations under the agreement.
 - The beneficiary called the bank guarantee.
 - **The Guarantor refused to make the payment** arguing that the bank guarantee was no longer effective as the underlying agreement was terminated.
- ✓ *The claim of the beneficiary was satisfied by the Supreme Court.*



The Judgment of the Supreme Court

- *“The **main characteristic** of the bank guarantee is its **independence** from the main duty.”*

- *“The bank guarantee is **a unilateral and unconditional undertaking** of the guarantor independent of the main agreement of the parties.”*

- *“The **independent nature** of the bank guarantee is **evident from the grounds** for refusal of payment under Georgian law:
 - 1) the **non-compliance** of the demand and presented documents with the conditions of the guarantee, and
 - 2) the **expiration of the term** of the **guarantee**.- None of which are related to the main duty of the principal under the main agreement.”*



The Judgment of the Supreme Court

- The **effectiveness of the bank guarantee** is *not dependent* on the **effectiveness of the main agreement** under Georgian law.
- Even if the main agreement is terminated, the beneficiary is entitled to call the bank guarantee.

Independent Nature of Bank Guarantees

Case № as-562-871-09 [2009]



□ *The Parties*

- The Beneficiary – the Municipal Development Fund (Claimant)
- The Guarantor – an insurance company (Respondent)

□ *The Facts*

- **A performance guarantee.**
 - **The underlying agreement:** an agreement on the rehabilitation of school buildings.
 - **The term of the main agreement was extended** due to the principal's failure to complete the works within the time for completion.
 - **The term of the bank guarantee was not extended explicitly** although the bank guarantee referred to the “effectiveness of the contract” as its validity term.
 - **The Bank Guarantee Agreement between the principal and the guarantor expressly provided the date that was the term of the underlying agreement.**
- *The claim of the beneficiary was not satisfied by the Supreme Court.*



The Judgment of the Supreme Court

- **Independent Duty.** The bank guarantee is distinct from other types of security of the agreement in that it is independent, not accessory, meaning that the main agreement cannot affect the bank guarantee.
- **The term of the bank guarantee** is *not automatically extended upon the extension of the term of the main agreement.*
- **Amendment to the terms** of the bank guarantee requires *a separate agreement of the parties.*

The Judgment of the Supreme Court

- **Two distinct agreements :**

1. The **agreement between the guarantor and the principal** on the issuance of the bank guarantee
2. The **bank guarantee** which is a unilateral undertaking of the **guarantor to the beneficiary**

- *“The guarantee amount shall be paid upon the demand of the beneficiary **without regard to the counterclaim** arising from the main agreement.”*
- *“The agreement between the guarantor and the principal does not affect the relationship between the guarantor and the beneficiary.”*

Independent Nature of Bank Guarantees

Case № as-1038-999-2016 [2017]



□ *The Parties*

- The Principal –company D
- The Beneficiary – the Ministry of Agriculture of Adjara A/R

□ *The Facts*

- **A performance guarantee.**
 - **The underlying agreement:** a procurement agreement on the sale of goods.
 - **The principal delayed the performance** of the agreement and paid the penalties for the delay to the beneficiary.
 - The beneficiary called the bank guarantee.
 - The bank made the payment.
 - **The principal** submitted a **claim** against the beneficiary on **unjust enrichment**.
- *The claim of the principal was not satisfied by the Supreme Court.*



The Judgment of the Supreme Court

- **Independent Duty.** The main characteristic of the bank guarantee is its independence from the main duty.
- **Not Accessory.** The bank guarantee is not an accessory duty. This is evident from the fact that the guarantor is not entitled to make a counterclaim based on the agreement between the principal and the beneficiary.
- Reference to **case № as-562-871-09 [2009]**.
- The bank guarantee secures the fulfillment of the beneficiary's claim even if the duty under the main agreement does not exist, is performed, terminated or invalid.
- **German case law.**



The Judgment of the Supreme Court

- **Purpose of the written demand** – To identify the beneficiary
- **Documents** – a demand shall be accompanied with the documents listed in the guarantee
- **No Burden to Proof the breach of the underlying agreement**

The Judgment of the Supreme Court

- **Duties of the Guarantor.**
- **Regress payment.** The guarantor shall pay the guarantee amount to the beneficiary. The principal shall indemnify the guarantor.
- **The grounds for refusal.**
 - Non-compliance
 - Expiration
 - Reference to case N as-781-996-08 dated March 17, 2009
- **No unjust enrichment** if the duty of payment exists under the bank guarantee without regard to the main agreement.

Complying Demand

Case № as-1229-1170-2014 [2015]



□ *The Parties*

- The City Hall of Batumi – the Beneficiary
- An insurance company – the Guarantor

□ *The Facts*

- A **performance guarantee** and an **advance payment guarantee**.
- **The underlying agreement:** a procurement agreement on the reconstruction of the kindergartens in Batumi.
- The beneficiary called both bank guarantees.
- The beneficiary indicated that the principal was in breach of main agreement but made no reference to the obligations related to the advance payment.
- *The claim was satisfied only in the part of payment of the performance guarantee.*



The Judgment of the Supreme Court

- “The beneficiary shall indicate in what respect the principal is in breach of the underlying agreement in order to comply with the conditions of the bank guarantee.”

Complying Demand

Case No as-396-376-2015 [2016]



□ *The Parties*

- Company N – the Principal
- Company T – the Guarantor

□ *The Facts*

- A **performance guarantee** and an **advance payment guarantee** **subject to URDG #758**
 - The underlying agreement: the sales agreement.
 - Principal **delayed the delivery** of the goods.
 - Beneficiary called both guarantees.
 - The Bank paid both guarantees.
 - The Principal submitted a claim on the unlawfulness of the payment by the bank and the **unjust enrichment** of the beneficiary.
- ✓ *the Court of Appeal held that the beneficiary was unjustly enriched.*



The Judgment of the Court of Appeals

- *“Guarantor was obliged to check the purpose of payment of the guarantee not only under the law but also under the agreement.”*
- *“The agreement clearly indicated that the guarantee was issued for advance payment. The name of the agreement directly referred to the advance payment. “*
- *“The agreement should have been breached, terminated and the beneficiary should have demanded the return of the advance payment before calling the bank guarantee which was not the case.”*
- Reference to URDG #758
- ✓ *The Supreme Court upheld the decision of the Court of Appeals.*

Complying Demand

Case № as-960-925-2016[2017]



□ *The Parties*

- Company A – the beneficiary.
- Company D – the Guarantor.

□ *The Facts*

- **A performance guarantee and an advance payment guarantee.**
 - **The Underlying agreement:** agreement “M” on the rehabilitation of the road “G” N 64.1-98.7. The scope of the agreement as amended: the tree cutting works on the road “G” N 64.1-74.0.
 - The scope of the agreement according to the Bank guarantees: rehabilitation of the road “P” N 24.0-64.1
 - The beneficiary called both guarantees.
 - The guarantor refused to make the payment based on **the discrepancy between the scope of the agreement and the conditions of the bank guarantee.**
- The claim of the beneficiary was not satisfied by the Supreme Court



The Judgment of the Supreme Court

- **Independent Duty**
- **Not Accessory**
- Reference to the case law:
 - Case N as-781-996-08 dated March 17, 2009
 - Case N as-562-871-09dated October 20, 2009
 - Case N as-1038-999-2016 dated 01.02.2017
- Reference to URDG #458, Art.2(b) and URDG #758, Art. 5.1
- Reference to the United Nations Convention on Independent Guarantees and Stand-By Letters of Credit, Art. 3.



The Judgment of the Supreme Court

- **Complying demand**
- *“it is important to check whether the demand arises from the obligation secured under the bank guarantee.”*
- *“if the information on the obligations contained in the bank guarantee is not identical to the obligations under the main agreement, at least they shall not contradict.”*
- *“The mistake related to the scope of the agreement, which is a substantial condition of the agreement, shall not be considered of minor importance for determining whether the bank guarantee is issued to secure a particular obligation.”*



The Judgment of the Supreme Court

- **The Principle of Strict Compliance**
- *“According to this principle, the demand of the beneficiary shall strictly comply with the conditions of the guarantee and shall be accompanied with the documents listed in the guarantee.”*
- *Reference to URDG #458, Art. 9*
- *The mechanism to protect the principal from the risk of the abuse of rights by the beneficiary.*



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