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## CASE LAW REVIEW

### Review of the Supreme Court Practice

DAVID KERESLIDZE\*

This review provides Supreme Court's assessment of specific aspects of some cases considered by the Georgian Courts. Moreover, short comments on the court's opinion and reference to some other decisions involving similar circumstances are offered. The wording and terminology of the court decisions is preserved.

#### 1. Loan Interest Amount

Under its Ruling No. 3k/809/01 of 19 October 2001<sup>1</sup> the Chamber of Civil, Entrepreneurial and Bankruptcy Cases of the Georgian Supreme Court partially satisfied the appeal and repealed the Ruling of 21 February 2001 of the Appellate Chamber for Civil, Entrepreneurial and Bankruptcy Cases of Kutaisi Regional Court. The appellant based his claim upon Article 625 of the Civil Code pursuant to which the parties to the contract may consider interest on a loan but this interest should reasonably comply with the amount fixed by the National Bank or Inter-bank Credit Auction.

##### 1.1 Circumstances of the Case

The facts of the case provide that the defendant borrowed nine hundred US dollars from the plaintiff. The plaintiff specified that the money was borrowed with a 10% monthly interest. They made a receipt at the moment of which 900 US dollars with accrued interest at the monthly 10% rate came to 3.000 US dollars. The Appellate Chamber for Civil, Entrepreneurial and Bankruptcy Cases of the Kutaisi Regional Court upheld the decision of 9 June 2.000 of Kutaisi City Court on the imposition of 3.000 US dollars on the defendant. It stated that according to Article 341 of the Georgian Civil Code, a written acknowledgement is necessary for validity of a contract under which the existence of an obligation has been acknowledged. In the present case the Regional Court found that in 1998 on the basis of an oral agreement the plaintiff issued a loan to the defendant amounting to 900 US dollars with 10% interest payment per month and that on 19 March 1999 the parties drew up a receipt signed by the defendant. This receipt verified that the defendant acknowledged in writing the existence of a debt amounting to 3000 US dollars. The Appellate Court stressed that the respondent's allegation that the receipt was signed under duress was not established.

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\* Deputy Director of GEPLAC for Legal Issues.

<sup>1</sup> Decisions of the Supreme Court of Georgia in Civil, Entrepreneurial and Bankruptcy Cases, 2002, No. 1, 165.

## 1.2 Supreme Court's Assessment

The Chamber of Civil, Entrepreneurial and Bankruptcy Cases of the Supreme Court stated that "under Article 341 of the Civil Code acknowledgement of the existence of a debt constitutes a contract. Such a transaction implies the initiation of a legal relation. Pursuant to Article 54 of the Civil Code, a transaction violating legally established rules and prohibitions, contradicting public order or morality shall be considered as void. If a transaction, acknowledging the existence of a debt conflicts with legally established rules and prohibitions, it shall be considered null and void. Article 625 of the Civil Code provides that parties may envisage interest on a loan, that shall reasonably comply with the amount fixed by the National Bank or by inter-bank credit auction".

Thus, the Supreme Court considers that "if between the parties there was a loan contract with the condition to pay interest, the loan and its interest shall be paid in accordance with the requirements of the law and all transactions that deviate from the requirements of the law shall be void. If it is proven that there was a loan contract between the parties without a condition of interest payment, an acknowledgement of the existence of the debt is null and void as well because it contradicts the requirement of the law. Pursuant to this requirement if the loan is not interest-bearing it shall be paid back without interest".

The Supreme Court found the conclusion of Kutaisi Regional Court erroneous because it reasoned that "since the parties have not presented evidence about the interest fixed by the inter-bank auction, the transaction shall not be considered void". The Supreme Court states that "the amount of the interest fixed by the National Bank or inter-bank credit auction constitutes the standard and commonly known fact that need not be proved and the court must apply it in any case".

## 1.3 Comment

To avoid ambiguity it is reasonable for the courts to explicitly point out, when referring to the second sentence of Article 625 of the Civil Code that the clause regarding the interest, violating the rule within the first sentence of Article 625 of the Civil Code, shall be void. As a consequence the validity of the transaction itself can not be discussed. Agreement on a particularly high interest shall not be a cause to invalidate the transaction itself - a loan contract or an agreement on acknowledgement of debt. Article 625 of the Civil Code does not provide for the grounds for nullity of the transaction. Moreover, it explicitly defines the scope within which the parties have discretion (reasonable compatibility with the amount of interest fixed by the National Bank or inter-bank credit auction). Otherwise, the law provides for the invalidity of a clause and not of a transaction. The requirement of Article 625 cannot serve as an invalidating factor for transactions under Article 54 of the Civil Code. Neither grounds as provided for in Article 55 of the Civil Code that could undoubtedly be closer with the circumstances of this case should be considered sufficient for invalidity.

The declaration of will by which the party acknowledges the existence of the debt in amount of 3.000 US dollars does not contradict with the requirement of any law. If the party bases his expression of will on wrong information, derived from a wrong presumption, was misled or even compelled, certainly, it should be taken into account. However, the circumstances of the case may reveal the existence of grounds for voidability only and not invalidity.

It would be rather useful if the court, taking into account the circumstances of this case, adopts a decision on bringing the interest rate in line with the amount of interest fixed by the National Bank or inter-bank credit auction. The probability that the lender might take advantage of a borrower's difficult economic or sometimes indigent condition and set an unreasonably high interest rate certainly needs the court's involvement. However, if such a transaction is deemed void (second sentence of Article 625 of the Civil Code should not be interpreted as requiring this) one might deal with similar unfairness. Instead of concluding a loan contract the lender could have used the money otherwise with the intention of receiving profit.

Furthermore, the first section of Article 625 of the Civil Code provides for a "reasonable" and not absolute compatibility with the amount of interest fixed by the National Bank or inter-bank credit auction. Consequently, agreement on interest lower than the fixed amount, as well as on its nonessential "reasonable" excess should be, generally, acceptable.

#### 1.4 Assessment of Similar Circumstances in other Decisions

Opinions expressed in other decisions of the Supreme Court concerning the "reasonable" amount of loan interest are equally interesting. In the No.3k/831-01 Decision of 17 October, 2001<sup>2</sup> the Chamber for Civil, Entrepreneurial and Bankruptcy Cases agreed with the Chamber for Civil, Entrepreneurial and Bankruptcy Cases of the Adjara Autonomous Republic High Court and found that under Article 625 of the Civil Code setting loan interest at 7% did not comply reasonably with the amount fixed by the inter-bank credit auction (the interest rate fixed by the inter-bank credit auction was 3%), thus the sum more than 3% was found as overpaid.

In the No.3k/817-01 Decision of 31 October, 2001<sup>3</sup> the Chamber of Civil, Entrepreneurial and Bankruptcy Cases stated that pursuant to the first part of Article 403 of the Civil Code, a debtor who delays payment of a sum of money is liable to pay interest fixed under the law for the delayed period of time. In addition, under Article 625 of the Civil Code the legally established interest must comply reasonably with the amount fixed by the National Bank or inter-bank credit auction. Accordingly, the court dismissed the plaintiff's claim of 15%

<sup>2</sup> Decisions of the Supreme Court of Georgia in Civil, Entrepreneurial and Bankruptcy Cases, 2002, No. 1, 141.

<sup>3</sup> Decisions of the Supreme Court of Georgia in Civil, Entrepreneurial and Bankruptcy Cases, 2002, No. 2, 253.

of the sum, which the party determined as monthly damage. Furthermore, the court stated that the amount fixed by the inter-bank credit auction in 1999 was 2.5%, in 2000 – 1.7% and in January-June of 2001 – 1%.

## 2. Null and Void or Irrefutably Void Transactions

Under Ruling No.3k/829 of 28 November 2001 the Chamber of Civil, Entrepreneurial and Bankruptcy Cases of the Georgian Supreme Court dismissed the appellant's claim and upheld the Decision of 4 June 2001 of the Panel of Civil and Entrepreneurial Cases of the Tbilisi Regional Court.

### 2.1 Circumstances of the Case

Tbilisi Regional Court found that the defendant L.L.C. and its partners were in arrears with the bank and budget. As security the company's and partners' shares were pledged. To recover its debts the bank called an auction where the partners' shares were offered. To avoid the auction the partners at a meeting held on 26 September 2000 decided to transfer their shares to cover the debts owed to the bank, if the purchasers would cover these debts. The same day new partners paid the debts and thus avoided the sale of shares at the auction. The same day the partners sold their shares to those new partners.

During the trial the plaintiff stated that on 25 September 2000 he signed a loan contract with the defendant that he concluded as an insurance against the new partners' failure to return the sum paid to the bank. If the new partners failed to repay the sum, on the basis of that contract the applicant would claim a corresponding sum from the L.L.C. The regional court observed that the loan agreement signed on 25 September 2000 between the defendant L.L.C. and the former partners (the plaintiff) was "an irrefutably void transaction concluded fictitiously not for that purpose".

### 2.2 Supreme Court's Assessment

The Supreme Court's Chamber for Civil, Entrepreneurial and Bankruptcy Cases considered that "the applicant's opinion concerning the wrongfulness of the interpretation of Articles 56 and 61 of the Civil Code by the Regional Court, namely considering the transaction as fictitious and irrefutably void is correct. The transaction on the loan concluded without intent to create legal consequences, in other words not to transfer the loan, is a null and irrefutably void transaction. Irrefutable invalidity does not lead to any legal consequence neither for contracting nor third parties, whereas a fictitious transaction between parties aims at the achievement of unlawful purpose.

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<sup>4</sup> Decisions of the Supreme Court of Georgia in Civil, Entrepreneurial and Bankruptcy Cases, 2002, No. 3, 356.

Following from the mentioned circumstances the Appellate Chamber holds the view that the loan contract in question is an irrefutably void transaction since it did not intend to give out a contract-envisaged loan, and for this reason alone, did not claim the return of the loan from a quasi creditor. However the fictitious transaction should not always be considered as an irrefutably void transaction.”

The Appellate Chamber also considered that “treating fictitious transaction equally with irrefutably void transaction by the Regional Court does not change the invalidity of this particular transaction. Pursuant to Article 623 of the Civil Code, under a loan agreement, the lender transfers to the borrower’s possession of money or other thing, while the borrower assumes an obligation to return the things of the same type, quality and amount. The loan agreement is of realistic nature. The existence of a loan agreement does not necessarily mean the existence of debt. Together with the agreement the subject of the loan shall be transferred. One cannot claim the existence of a loan if money or an object has not been received by the borrower. If the borrower assumes the obligation to return to the creditor what he has not received, such an agreement shall be deemed as irrefutably void. If it is established that in reality the loan did not involve the transfer of any funds, all such contracts concluded with quasi creditors shall be null and void”.

### 2.3 Comment

The Civil Code provides for void and voidable transactions. The difference between these two constructs is that a void transaction is deemed as such from the moment of its conclusion and does not cause legal consequence. A voidable transaction remains valid until the person having the right to challenge it uses this right. In the event of a challenge a voidable transaction becomes void upon its conclusion. However, should it not be challenged, it remains valid and consequently the rights and duties that arise at the moment of its conclusion remain enforceable. Thus, the difference between these two constructs is that, unlike invalidity, voidability causes legal consequences and the recognition of its invalidity depends upon the will of the party.

As for an irrefutably void transaction, it should be considered as the synonym specifying the contents of void transaction and not as a separate phenomenon. The wording “irrefutably void” specifies that the determination of its invalidity does not need additional challenge. Consequently, it would be reasonable for the Supreme Court not to use vague wording, such as for instance “Appellate Chamber considers that equalisation of fictitious transaction with irrefutably void transaction by the Regional Court does not change the invalidity of this particular transaction” or that “fictitious transaction cannot always be considered as an irrefutably void transaction”. The fictitious transaction, pursuant to the first section of Article 56 of the Civil Code, always is void i.e. is an irrefutably void transaction, and its invalidity does not depend on a challenge.

#### 2.4 Assessment of Similar Circumstances in other Decisions

The opinion expressed in the No.3k/1012-01 Ruling of 16 January 2002 of the Chamber of Civil, Entrepreneurial and Bankruptcy Cases of the Supreme Court is interesting. The court stated that “the existence of a written form of loan contract does not mean that this contract can not be fictitious or a sham. One can not discuss the issue of a loan if the borrower has not received any money. A loan contract shall be deemed irrefutably void if the non-existence of money within the contract is established. In other words a transaction is irrefutably void when a borrower assumes the obligation to pay back to the creditor what he has not received”.

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<sup>5</sup>Decisions of the Supreme Court of Georgia in Civil, Entrepreneurial and Bankruptcy Cases, 2002, No. 4, 553.