CASE LAW REVIEW

Application of the Provisions on Unjust Enrichment

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The provisions regulating the institution of unjust enrichment introduced by the 1997 Civil Code of Georgia (GCC) were elaborated based on German law. However, the potential function of this institution in Georgian law differs to some extent from German law due to the lack of the so-called principle of abstraction of the transfer of ownership right. The principle of abstraction considers grounds for transfer of ownership under the law of obligations and transaction under the law of things separately from each other – "abstractly". The principle of abstraction in Germany leads to the situation when the invalidity of a contract under the law of obligations does not cause the invalidity of a contract under the law of things. Consequently, the initial owner has to claim the return of a thing from a new owner based on the provisions on unjust enrichment.

Georgia applies different system for the acquisition of ownership right based on the so-called causal system. To acquire an ownership right on movable property a "valid right" is necessary and consequently its (e.g. a contract under the law of obligations) lack or invalidity automatically causes the invalidity of a contract under the law of things (e.g. on transfer of ownership right). In such cases, the ownership right is not transferred and under Article 172 I GCC the owner may revendicate the thing from its possessor. The application of the rules of unjust enrichment is unjustified in this case.

Below we examine the application of provisions on unjust enrichment provided for by the GCC in Decision No. 3k/304-02[1] and Ruling No. 3k/1202-01[2] of 24 April 2002 of the Chamber for Civil, Entrepreneurial and Bankruptcy Cases of the Georgian Supreme Court.

1. Return of Earnest Money

In its Decision No. 3k/304-02 the Chamber for Civil, Entrepreneurial and Bankruptcy Cases of the Georgian Supreme Court upheld the Decision of 18 January 2002 of the Chamber for Civil, Entrepreneurial and Bankruptcy Cases of the Tbilisi District Court on obliging the defendant to return the earnest money.

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[1] Decisions of the Supreme Court of Georgia on Civil, Entrepreneurial and Bankruptcy Cases, 2002, No. 7, 1076.

[2] Decisions of the Supreme Court of Georgia on Civil, Entrepreneurial and Bankruptcy Cases, 2002, No. 7, 1079.

1.1 Circumstances of the Case

From the descriptive part of the case it follows that oral agreement was concluded between the claimants and defendant on the sale of a house due to which the claimants deposited 3 300 USD to the defendant. The Appellate Court did not consider the above noted sum as earnest money for under Article 421 GCC "earnest money is a sum of money paid by one party to a contract to the other party as evidence of the conclusion of the contract". Thus the earnest money is the part of main contract. As per Article 327 I GCC "a contract is considered concluded, if the parties have agreed on all of its essential terms in the form prescribed for it". Whereas under Article 323 of this Code "a contract by which one party undertakes the obligation to transfer ownership of an immovable thing to another person or to acquire it shall be subject to notarisation".

Since in the given case the form of conclusion of transaction was not observed the Appellate Court did not consider the deposited 3 300 USD as earnest money and by referring to Articles 59 and 69 GCC ruled its return.

1.2 Assessment of the Supreme Court

In addition the Supreme Court contended that according to the GCC if for the validity of the contract the law prescribes certain form, then the contract enters into force only if such requirement is observed. In this case the parties concluded a contract on the sale of a house and the sum paid as an evidence of the conclusion of this contract should be documented in the form prescribed for a real estate sales contract. Respectively, since the sum paid as evidence of the conclusion of the sales contract was not notarised it shall be considered void for non-observance of the required form.

As per Article 976 I a GCC, "a person who transferred something constituting performance of an obligation to another person may claim from the pseudo creditor its return if the obligation, due to its being void or other grounds, does not exist..." In this case, since the earnest money for the purchase of the house was deposited without observance of the required form, the fact of conclusion of the purchase contract can not be deemed proved due to the non-observance of the prescribed form. Thus it is void and the creditor may claim the return of the deposited sum.

1.3 Comments

The Chamber for Civil, Entrepreneurial and Bankruptcy Cases of the Tbilisi District Court fairly commented about the notarisation of the contract on transfer of ownership on an immovable thing under Article 323 GCC and declared the contract existing between the parties as void under Article 59 GCC.

In such cases the claim on the return of a thing (earnest money) derives from Article 172 I GCC pursuant to which the owner may claim the revendication of the thing from its pos-

sessor. Apparently the court deemed the application of this Article to the earnest money as unreasonable and ruled its return under Articles 59 and 69 GCC.

Articles 59 and 69 GCC as referred to by the Tbilisi District Court do not provide for (any) right to a claim and so the party can not claim anything based on these Articles. Article 69 GCC provides for the types of form of transaction or more precisely of declaration of will. Whereas Article 59 GCC stipulates the nullity of transaction made without observance of the form. Respectively the Supreme Court fairly refused the application of these Articles as grounds for the claim. However, the court itself runs from one extreme to another and entitles the party to the right to claim without indicating the provision originating the claim.

The Supreme Court's comment stating that "earnest money as the sum paid down as evidence of conclusion of the contract shall be made in the form prescribed by the real estate purchase contract" is ill-founded. Articles 421-423 GCC do not provide for such a requirement with regard to earnest money and since the law does not provide for observance of a special form the principle of freedom of form shall be applicable. Indeed Article 422 GCC clarifies that "earnest money is counted towards the payment account stipulated by the obligation..." in other words it should be understood as partial performance of the obligation as well.

The application of Article 976 I a GCC is also unreasonable which states that "a person who transferred something constituting performance of an obligation to another person may claim from the pseudo creditor its return if the obligation, due to its being void or other grounds, does not exist". Prima facie it seems to be a special type of Article 172 I GCC but unless an owner loses the ownership right on the thing he has the owner's strongest right to claim – the right to claim the revendication of his property from the possessor. Respectively it is wrong to verify the occurrence of the fact of "unjust enrichment" and to apply Article 976 GCC as the right to claim (Besides it should be mentioned that enrichment occurs when the party somehow benefits. As such this could be considered as the acquisition of the right to claim or ownership right. As for the right to possession it depends from case to case).

The court should consider the sum of money as an immovable thing and while discussing the issue of acquisition of ownership right on it, should be guided by the preconditions provided for by Article 186 GCC. The other party shall acquire the ownership right on earnest money if it is transferred to him on the grounds of "a valid right". If a valid right does not exist (at all or any more) the transaction on transfer of ownership right under the law of things shall become "automatically" void i.e. the other party will not become the owner of money.

In this case due to nullity of the contract, the transfer of ownership right had not occurred due to the non-observance of the precondition of Article 186 I GCC i.e. valid right does not exist. Respectively, under Article 172 I GCC, the party can claim the revendication of the earnest money as the owner from the possessor.

2. Return of Paid Money

In its Ruling No. 3k/1202-01 of 24 April 2002 the Chamber for Civil, Entrepreneurial and Bankruptcy Cases of the Georgian Supreme Court repealed the Decision dated 10 September 2001 of the Civil, Entrepreneurial and Bankruptcy Cases of the High Court of Adjara Autonomous Republic and contended that the Court should have been guided by Articles concerning unjust enrichment instead of rental law.

2.1 Circumstances of the Case

The claimant concluded a contract with the defendant according to which the building frame of a three-story unfinished house owned by the defendant would be transferred into ownership of the claimant, if the latter paid its price gradually during one year.

The claimant paid the defendant half of the building frame's price and after one year a new contract was concluded according to which the defendant was charged to pay the interest of the remaining sum. The already paid sum and construction costs remained in the form of a mortgage. Provided the claimant did not pay the remaining sum during three years, the mortgaged property would not be returned to him. Later the claimant found out that this contract was concluded in violation of the law.

In the claim, the claimant demanded a conclusion of the sales contract between him and the defendant in full compliance with the requirements of the legislation or otherwise to charge the defendant to pay the construction costs, the already paid sum and court expenses. The defendant did not acknowledge the claim and objected the conclusion of the purchase contract because the claimant did not perform the obligation under the contract and did not pay the full price of the building frame.

The High Court of Adjara Autonomous Republic was guided by the finding of one of the experts to the case and charged the defendant to reimburse the expenses incurred by the claimant (partially satisfied claimant's claim). In making its decision, the Court used Articles 352 and 548 GCC. The Court deemed that under the contract, the claimant should not have run the construction since the contract could not have envisaged the purchase of this building by the claimant and the latter was obliged to draw estimates together with the owner because the construction and not current repair was going on there.

2.2 Assessment of the Supreme Court

The Supreme Court considered the Decision of the High Court of Adjara Autonomous Republic as ill-founded. Namely it clarified that the High Court of Adjara Autonomous Republic should not have applied Article 548 GCC regulating the expenses of current repair under the rental contract, because no rental contract was made between the parties. In addition, the High Court of Adjara Autonomous Republic should not have applied Article 352 GCC because this rule regulates the consequences of a repudiation of a contract.

Based on verified facts the Supreme Court decided that the contracts made between the parties are void transactions concluded without observance of the appropriate form. Articles 183 and 323 GCC provide for a "qualified" form of notarisation of a contract that was not observed by the parties. The Court indicated that under Article 59 I GCC a transaction is void when it is made without observance of the form provided for by the law and under Article 61 GCC it is deemed void from the moment of its making. In cases like this the parties to a transaction become entitled to demand what they have transferred to another party for the performance of an obligation. In this case the Court deemed that legal grounds of the claimant's claim are Articles 976 I and 987 I GCC under which a person who either intentionally or by mistake has incurred expenses with respect to another person's property, may demand from this person compensation for the expenses incurred if the latter was enriched thereby. Consequently the Supreme Court repealed the Decision of the High Court of Adjara Autonomous Republic and sent the case for review back to the same Court.

2.3 Comments

In this case the question is whether the right to claim provided for by Article 172 I and not by Article 987 GCC originated. Namely it should be verified whether or not the other party has become the owner of "expenses" incurred for his property i.e. the paid sum of money and "construction costs" (building material and service outputs). The subject here concerns transfer or acquisition of ownership right on a movable thing (money, building materials and service outputs) and account should be taken of the preconditions of transfer of ownership right on movables from one person to another.

The transfer of ownership right on money takes place under Article 186 GCC by handing the thing over on the grounds of a valid right. Respectively the ownership right on money was not transferred and the owner may demand from the possessor its return under Article 172 I GCC.

The situation changes when it concerns the "expenses" the ownership right on which is acquired not by handing over the property (thing) on the grounds of a valid right but as prescribed by Article 193 GCC i.e. when movable thing (building materials) is attached to the land plot or other immovable property. Although in this case the law speaks only of the land plot but its scope should also cover its essential component i.e. buildings and other constructions firmly attached to the land (Articles 149 and 150 II GCC). In this case the party became the owner of "expenses" i.e. building materials and service outputs due to circumstances prescribed by Article 193 GCC. Namely, they have become the essential components of the building frame and thus of a land plot. This leads to the origin of the claim of compensation for damage under Article 197 I GCC.

Consequently, it would be reasonable if the party's right to claim was based upon the rights to claim under Articles 172 I and 197 I GCC.

Loan Interest Amount

In one of our previous editions we discussed several rulings and decisions adopted by the Chamber for Civil, Entrepreneurial and Bankruptcy Cases of the Georgian Supreme Court. Based on Article 625 GCC the Court adopted a decision with regard to fixing a particularly high loan interest. Namely, Ruling No. 3k/809-01 of 19 October 2001, Decision No. 3k/831-01 of 17 October, 2001 and Decision No. 3k/817-01 of 31 October, 2001.[1]

In this respect it was noted that it would be reasonable to consider interest agreement concluded in violation of the rule under Article 625 GCC as void and invalidity of the transaction itself could not be discussed and that the court ought to have adopted a decision on bringing the interest rate in line with the interest amount fixed by the National Bank or Inter-bank Credit Auction. In addition, it stated that Article 625 GCC provides for "reasonable" and not absolute compatibility with the amount of interest fixed by the National Bank or Inter-bank Credit Auction and consequently, agreement on interest lower than the amount, as well as its nonessential, "reasonable" excess should be generally acceptable.

It is particularly pleasing that in Decision No. 3k/278-02[2] of the Chamber for Civil, Entrepreneurial and Bankruptcy Cases of the Georgian Supreme Court it was considered to impose on the defendant 3% instead of 10% loan interest as prescribed by the loan agreement (amount of interest fixed at the Inter-bank Credit Auction made up average 2.8% per month). The Court deemed void the agreement on imposition of 10% loan interest and not the loan agreement itself. Respectively, the Court added that the invalidity of the part of transaction under Article 62 GCC does not mean the invalidity of its other part if it is presumed that it could have been concluded even without its void part.

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[1] see *Kereselidze,* Loan Interest Amount, Georgian Law Review, 5/2002, 392.
[2] Decisions of the Supreme Court of Georgia on Civil, Entrepreneurial and Bankruptcy Cases, 2002, No. 6, 886.