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Judicial Reduction of Penalties in Georgian Civil Law: Balancing Debtor and Creditor Rights

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Abstract

General Background: Judicial discretion in the reduction of penalties plays a crucial role in balancing the interests of contracting parties under the Civil Code of Georgia. **Specific Background:** Article 420 grants courts the authority to reduce disproportionately high penalties, yet the lack of explicit legal criteria leaves room for case-by-case judicial interpretation. **Knowledge Gap:** Despite the volume of case law, there remains no standardized framework guiding courts in determining what constitutes an “inappropriately high” penalty. **Aims:** This study seeks to analyze Georgian court decisions to identify patterns and criteria employed when reducing penalties under Article 420. **Results:** The findings reveal that courts emphasize proportionality, reasonableness, and the specific circumstances of the breach, including the degree of fault and the scope of unfulfilled obligations. Moreover, the financial status of the parties and market expectations further influence judicial decisions. **Novelty:** This article consolidates judicial practices to offer a comprehensive framework for reducing penalties, contributing to both theoretical understanding and practical application in legal practice. It introduces a calculation methodology and suggests criteria for equitable penalty reduction in specific legal relationships. **Implications:** These insights will support legal practitioners in formulating fairer contracts, assist courts in maintaining contractual balance, and guide future legal reforms, fostering both justice and efficiency in contractual relationships. **Highlights:**

- Georgian courts use proportionality and reasonableness to reduce penalties under Article 420.
- The absence of explicit legal criteria allows case-by-case interpretation, ensuring flexibility but creating inconsistency.
- Financial status, market expectations, and fault degree influence the court’s discretionary decisions.

Keywords: Penalty, Discretionary Power, Civil Code, Contractual Balance, Judicial Practice

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Introduction

According to the Civil Code of Georgia [1], the court has the authority to reduce an inappropriately high penalty. This provision is frequently applied in contractual relationships, such as loan agreements, state procurement contracts, and others.

In particular, the debtor can apply to the court to protect their rights and, based on the mentioned provision, can request a reduction of an inappropriately high penalty. Similarly, the creditor has the right, based on the contract, to seek a reduction of the penalty by the court.

There are many litigations in Georgian courts where, based on the authority granted by the Civil Code of Georgia, the court reduces the penalty. However, the relevance of this research topic lies in the fact that, despite considerable litigation surrounding this article, there is still no established standard for assessing an inappropriately high threshold, the court evaluates this issue on a case-by-case basis. This is what makes the topic timely, as it aims to establish specific criteria based on an analysis of existing judicial practice, these criteria would help determine when the court considers a penalty amount to be inappropriately high.

The term 'disproportionately high,' as used by the legislator, is vague and serves as an evaluative category, which may seem fair to one party but not to the other. Therefore, while applying this article, the court should be guided by the standard of justice and assess the amount of liquidated damages in cases where there is a clear disproportion between the breached obligation and the imposed liquidated damages, so as to maintain the right balance between the rights of the debtor and the creditor.

In addition, when evaluating whether the penalty is inappropriately high, the court considers other circumstances, which will be discussed in the analysis of judicial practice in this article.

When applying the mentioned provision, the court must follow the principle of balance and interpret the rule in a way that clearly shows the penalty amount is excessively high, taking into account the specific circumstances of the case.

This will be thoroughly examined in the present article through an analysis of court decisions.

The purpose of the article is to: discuss court decisions based on Article 420 of the Civil Code of Georgia; generalize the criteria by which the court evaluates an inappropriately high penalty; and analyze the extent to which the court reduces the penalty.

According to the Civil Code of Georgia, the court has discretionary authority to reduce an inappropriately high penalty. The judge makes this decision based on the circumstances of the case.

This provision grants the judge discretionary power to determine under what circumstances and on what basis reduce the penalty imposed on a party.

In legal scientific literature, there is an interesting definition of the court's discretionary powers. Specifically, it is noted that 'the purpose of discretion is, first and foremost, to clarify the legal relationship by the court.' [2] This authority can be interpreted both broadly and narrowly. From a broad perspective, discretionary authority is seen as the judge's freedom to interpret various norms. From a narrower perspective, it means that the law must explicitly grant this authority to the judge. The authority specified in the named provision is granted to the court by the legislator. Therefore, the judge has full discretion to determine whether the amount of the fine is disproportionately high based on the circumstances of a specific case and to decide whether or not to reduce it.

In legal literature, discretion is often categorized into 'simple instructions' and 'categories of assessment', however, the legislator may also use additional categories that do not allow the court to clearly define the list of legally significant facts directly based on the norm", for example, in Article 420 of the Civil Code, the term 'circumstances' mentioned in the norm does not represent evaluative categories. However, it does refer to a general concept that is not specific, allowing the court a degree of freedom in its interpretation." [4] One of the purposes of judicial discretion is to clarify the rights and duties of specific parties involved in a defined legal relationship [5].

The application of Article 420 of the Civil Code of Georgia by the court can be described as a discretionary power of the judge. In this respect, the legislator has introduced an element of procedural law into substantive legislation. "Substantive law sometimes includes norms of a procedural nature, as clearly illustrated by the presence of Article 420 in the Civil Code of Georgia.

Since the legislator does not provide an exhaustive list of cases in which the court may consider the amount of the fine as 'disproportionately high,' the decision is left to the court's discretion. This means that it is within the court's discretion to determine whether the amount of punitive damages imposed on a party is disproportionately high in a particular case.

This approach by the legislator is noteworthy. The presence of this norm in the Civil Code is undoubtedly justified, as there are many cases in practice where judges have correctly applied the norm when it was evident that the amount of the penalty was disproportionately high.

Additionally, while parties have the freedom to determine severance terms based on their mutual agreement within the framework of contractual freedom, this does not imply that the amount of severance pay should be excessively high. It is to address this issue that the legislator introduced the mentioned norm, granting the court, as a body that determines justice, the authority to balance the legal status of the parties and, based on the principles of fairness and objectivity, to decide the amount of compensation in each specific case.

Justice, objectivity, and the principle of balancing the rights and obligations of the parties should be the determining criteria when the judge addresses this issue.

Method

The article employs analysis and synthesis, as well as logical and normative methods. It will discuss the decisions made by judges based on this article, review scholarly opinions, and provide a final analysis regarding the article.

The scientific novelty of this paper lies in the in-depth analysis of Article 420 of the Civil Code of Georgia, which will be presented in this article.

The scientific novelty of the paper will be highlighted by the establishment of criteria that the court uses to reduce the amount of penalties. The mentioned criterias are numerous and will be presented in a consolidated form in this work. This will be of interest to both those studying the issue and practitioners.

Additionally, the scientific novelty of the paper will be highlighted by proposing a specific amount and calculation method for penalties tailored to particular legal relationships. This will be of interest to both theorists and practicing lawyers.

The paper will have both theoretical and practical significance. Theoretically, it will be of interest to researchers focused on the legal regulation of penalty reductions by the court, as it explores the essence of penalty reduction in the context of a comprehensive analysis of relevant legal norms. It also examines the judicial practice surrounding this institution. Additionally, the paper will be of interest to all researchers as it provides an in-depth discussion of the institution in question.

The practical value of the paper lies in its analysis of existing court practice, which will assist lawyers and judges in navigating the use of reduction authority.

Result and Discussion

A. The Essence of Penalty

1. The Essence of the Penalty Institute in Georgian Legislation

Articles 417-420 of the Civil Code of Georgia regulate the penalty institute. According to the Civil Code of Georgia, the penalty institute serves as an additional means of enforcing claims. It is an additional means for the creditor to satisfy their claim against the debtor. As an additional means of securing a claim, the penalty can be used in any type of contract. The law does not impose any restrictions in this regard; however, the only requirement for this institute is that it must be documented in writing.

The contract itself serves as the basis for imposing a penalty. If the contract does not specify a penalty for breach or improper performance, it cannot be imposed on the party [6].

In practice, penalties are primarily imposed for exceeding deadlines; however, this does not mean that exceeding deadlines is the only reason for which a penalty may be applied. The general criterion established by law, such as breach or improper performance of a contract, allows the parties to determine, by mutual agreement, the penalty for any such violation.

Article 417 of the Civil Code of Georgia [7] defines a penalty. According to this article, the purpose of a penalty is to ensure the creditor's satisfaction in the event of non-performance or improper performance of an obligation.

The essence of this institution is clarified by various court decisions.

In one case, the Cassation Chamber explains that a breach of contract serves to protect the party's interest in the performance of the obligation, and that "the obligation to pay arises from the violation of the obligation." [8]

The existence of the Penalty Institute serves to protect the creditor's interests in civil transactions. It is related to the generally recognized principle of "good faith" in civil law. Violation of the mentioned principle may result in non-performance or improper performance of an obligation, which in turn gives the creditor the right to claim against the debtor.

Essentially, the penalty should be calculated based on the amount of the unfulfilled obligation, rather than the full value of the contract. Since non-performance or improper performance of an obligation is related to the right to seek enforcement, the period for which the defaulting debtor should be held accountable is tied to the unfulfilled obligation.

In its decisions, the court clarifies the essence and function of a breach of contract and establishes the criteria for when a penalty should be imposed on the breaching party. These aspects will be discussed in the analysis of court decisions in the following sections.

The main essence of this institution is to protect the creditor's interests in the event of non-performance or improper performance of an obligation.

The Court of Cassation has explained in several decisions that: "The purpose of a penalty is to avoid a breach or non-performance of an obligation and in the event of a breach, to provide compensation for what is termed "presumed minimum damage", which, of course, does not represent a monetary amount equivalent to the actual damage, nor does it serve to fully compensate for the actual damage." [9]

2. Prerequisites for the Imposition of a Penalty

Article 417 of the Civil Code of Georgia establishes the prerequisites for the imposition of a penalty, according to which a penalty is imposed in the case of non-performance or improper performance of an obligation.

The legislator also establishes the mandatory written form for the transaction [10].

When imposing a penalty, the court considers the following criteria: a) the function of the penalty, as a sanctioning instrument, is to prevent further violations of obligations; b) the severity and extent of the violation, as well as the degree of risk posed to the creditor; c) the degree of fault of the person violating the obligation; d) The role of the breacher should include compensation for damages. When determining the amount of the penalty, the duration of the debtor's non-fulfillment of the obligation should be taken into account.

In each specific case, the court determines whether to impose a penalty for example, in one case, the court did not impose a penalty on the defendant based on the argument that, the obligations assumed by the contract were fulfilled by the defendant in good faith and conscientiously, accordingly, there was no basis for imposing the penalty [11].

However, in each specific case, the court assesses the breach of obligation and improper performance, and then decides whether to impose a penalty.

In this regard, the experience of foreign countries, particularly Spain, is noteworthy. Spanish law allows the court to reduce the penalty if the breach of contract is less severe than what was stipulated by the parties in the contract. Spanish law (Article 1154) authorizes the judge to modify the penalty only if the obligation has been partially or irregularly fulfilled. To reduce the penalty, the judge must evaluate the ratio between the actual performance and the performance that would have prevented the imposition of a penalty [12].

Judicial intervention in fines is an exception in French law, as disproportionality must result from an abuse of coercion that is manifestly excessive and unjustified.

While under Spanish law, judicial intervention in fines can only result in a reduction of the stipulated amount, in French law, the judge can reduce the fine if it is deemed clearly excessive or increase it if it is significantly low [13].

B. Reduction of an Inappropriately High Penalty by the Court

1. The essence of an Inappropriately High Penalty

The Civil Code of Georgia grants judges the discretionary authority to reduce a penalty if, according to the legislator's guidelines, it is deemed "disproportionately high". However, the law does not specify the circumstances under which a penalty may be considered inappropriately high. The determination of this is left to the discretion of the court.

In each specific case, the court determines whether the penalty is disproportionately high. Judicial practice provides certain criteria for reducing fines, though the decision is always made on a case-by-case basis. The court's

authority to reduce penalties for breach of contract should not be exercised unfairly, and neither party to the contract should be placed in an unequal position.

The judge must fairly and objectively assess the penalty for the breach of contract in relation to the breached obligation. For example, the issue of imposing a penalty can be determined by considering factors such as the unfulfilled obligation, its scope, the severity of the breach, and the duration of the violation [14].

As explained in legal scholarship, the most common instances of reducing penalties for breach of contract occur in cases involving standard form contracts with consumers [15].

In practice, penalties as a form of sanction are utilized in various types of contracts, including loan agreements, state procurement contracts, and others.

2. Prerequisites for Court-Ordered Reduction of Penalties

As mentioned in the introduction, the purpose of this article is to highlight the grounds for the court's reduction of penalties, as well as the circumstances that the court considers when exercising this authority.

It is important to determine the amount from which the penalty is calculated—whether from the full value of the contract or solely from the unfulfilled obligations. As noted in legal scholarship, penalties are calculated based on the value of the obligations that have not been properly performed [16].

It is also important to consider the method of calculation. For example, if the performance term of the obligation under the contract is defined in working days, but the creditor imposes a penalty based on calendar days, the penalty may also be subject to reduction [17].

The term “inappropriately high penalty” is the central research question of this article. Determining what constitutes an 'inappropriately high' amount is at the court's discretion; however, there is no legal standard guiding this determination. Considering that Georgian judicial practice includes numerous cases of penalty reduction based on this premise, we can conclude that a primary criterion guiding the court is the clear inconsistency between the breach of obligation and the penalty imposed, although there are additional factors as well. This article presents a court decision that outlines the criteria the court relies on when reducing the penalty threshold.

Regarding the prerequisites for imposing a penalty, it must first be stipulated in the contract, and a written agreement concerning the penalty is necessary; otherwise, the request for it is not permitted. Additionally, there must be a culpable violation of the contractual obligation. Furthermore, the principle of proportionality should be observed when comparing the damage caused by the penalty. As explained in legal scholarship, the penalty should not be unreasonably high in relation to the damage caused by the non-fulfillment of the obligation; according to judicial practice, such penalty is subject to reduction [18].

In addition to the aforementioned prerequisites, the court considers the parties' financial situations, their market positions, legal status, the creditor's expectations regarding timely fulfillment of the obligation, and other relevant factors [19].

Additionally, the court considers all circumstances arising from the conclusion of the contract until the amount of the penalty becomes disputed, which may serve as the basis for determining any discrepancies in that amount [20].

Procedural norms are also important in the reduction of penalties, particularly regarding how the disputing party should formulate the request in the lawsuit. An example of this is a request to amend the enforcement document issued by the notary, along with a request to reduce the penalty. The debtor can submit a reduction request for the debt in this manner [21].

It should also be noted that the method of calculating penalties is important. When the court reduces an inappropriately high penalty, the focus is on the amount to which the penalty is reduced and the criteria the judge uses in making that determination.

For example, during state procurement, the State Procurement Agency issued a recommendation [22], that the purchasing organizations set a penalty of 0.02% for each overdue day; therefore, the court may rely on this recommendation when reducing the penalty.

Additionally, penalty should be calculated not from the full value of the contract, as the creditor often claims in a lawsuit against the defendant, but rather from the remaining obligations that need to be fulfilled. This is also an important recommendation that the judge should consider when making a decision. The essence of penalty

1. The essence of the penalty institute in Georgian legislation
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1. The essence of an inappropriately high penalty
2. Prerequisites for Court-Ordered Reduction of Penalties
3. Analysis of Judicial Practice

3. Analysis of Judicial Practice

One significant case involves the reduction of an inappropriately high penalty, where courts at different instances reached varying decisions regarding the penalty reduction.

In particular, the subject of the dispute was the claim for payment from the defendant based on a lease contract. The defendant violated the obligation to pay the lease rent, and in addition to the overdue rent, the plaintiff demanded the imposition of a penalty on the defendant in the amount of - 27,175.00 GEL.

According to the decision of the Civil Affairs Board of the Tbilisi City Court, the claim was partially satisfied. The defendant was ordered to pay 37,500 GEL and an additional 1,000 GEL as a penalty in favor of the plaintiff.

According to the judgment of the Court of Appeal, the appealed decision remained unchanged. The appellate court also made an important clarification regarding the penalty.

The Appeals Chamber noted in its decision that, in determining the amount of penalty, it is important to assess how the defendant's repeated failure to fulfill the assumed obligation was manifested. In this case, the failure to pay the lease rent as stipulated in the contract was demonstrated by the defendant's untimely fulfillment of their obligation. Accordingly, the Chamber concluded that, due to this specific nature of the violation, the amount of the penalty should be reduced based on Articles 115 and 420 of the Civil Code, and was correctly determined by the appealed decision to be 1,000 GEL.

It should be noted the standard by which the court was guided in reducing the penalty. The court determined that, since the non-fulfillment of the obligation was manifested solely by the non-payment of rent, the amount of the penalty was excessively high. The Chamber did not view the violation as serious enough to impose the requested penalty amount on the party. This explanation is important, as the court does not consider the non-payment of rent a sufficient reason to impose the full penalty amount on the defendant, leading to a reduction of the penalty.

The plaintiff appealed the decision of the Court of Appeal through the cassation procedure, requesting the annulment of the appealed decision and the full satisfaction of the claim through a new ruling. According to the claimant, the decision made by the lower court has lost its function as a penalty intended to compel the party to fulfill the obligation on time and to provide a guarantee for the creditor in the event of damage, thus failing to satisfy the demand.

The cassation chamber annulled the appealed judgment regarding the penalty and partially satisfied the claim.

The Supreme Court made an important clarification regarding the reduction of the penalty. In particular, in this case, the cassation chamber explained that 'the penalty is a means of ensuring the party's corresponding interest in fulfilling the obligation, and the obligation to pay arises from the violation of that obligation. The party is liable for paying the penalty from the time the breached obligation should have been fulfilled until the obligation is fulfilled. In this case, the penalty serves to protect the creditor's interest in the timely fulfillment of the obligation [23].

The Cassation Chamber bases its decision on the principle of contractual equilibrium/balance and explains that "the penalty is primarily a legal mechanism that safeguards the interests of the creditor, thereby reducing the creditor's contractual risks" [24], however, the court emphasizes that there should be no abuse of rights by the creditor and the value to be assessed and protected in each specific case is the contractual equilibrium/balance, on one hand, there is the penalty as an expression of contractual freedom, and on the other, the protection of the debtor as a legitimate limitation of that freedom."

The Chamber highlighted the court's established uniform practice in reducing the penalty, which established the circumstances that the court relied upon in reducing the penalty. Based on this definition, we can establish specific criteria and circumstances outlined by uniform judicial practice for the reduction of penalties, namely:

"The function of the penalty as a sanctioning instrument, the severity and scope of the violation, the danger posed to the creditor, the degree of the debtor's culpability, and the duration of the debtor's non-fulfillment of the obligation" [25].

In addition, the court outlines the following prerequisites for the reduction of the penalty:

- a) the property status of the parties;
- b) the degree of breach of obligation ;
- c) the creditor's expectation of the proper performance of the obligation;

d) the property situation and other circumstances, particularly the ratio of the cost of performance, non-performance, and the damage caused by non-performance to the amount of the breach. ”

The first-instance court should have adhered to the mentioned criteria; it was insufficient for the court to simply state that the non-payment of rent was the reason for imposing penalty. He needed to assess the degree and severity of the breach of obligation.

In addition, the chamber emphasizes that the creditor should not benefit unjustly from accepting the penalty, which is quite correct, as the purpose of the penalty is to uphold the legality of civil transactions in cases of breach or delayed performance of obligations and to satisfy the creditor. However, since the principle of contractual freedom allows the parties to determine the amount of the penalty in the contract, and the law does not establish either a minimum or maximum limit in this regard, in this case, there may be a violation of the principle of equality. The creditor should not abuse their rights, and it is not permissible to impose an unreasonable penalty in the contract, in addition, according to the Supreme Court's guidelines, the penalty should be proportional, balanced, and reasonable in relation to the violation of the obligation.

In this case under consideration, the cassation court took into account the specific circumstances, including the unfulfilled obligation, its scope, the severity and duration of the violation, and concluded that the penalty imposed on the defendant by the lower court, amounting to - 1,000 GEL, was contrary to the legal nature of the penalty, violating the principles of proportionality, reasonableness, and justice.

In addition, the cassation chamber found that the penalty stipulated in the contract was clearly inconsistent with the breach of obligation in the case at hand. Based on the above criteria, the Court of Cassation took into account the cost of performance, the severity and extent of the violation, the degree of fault of the violator, and the consequences, concluding that the penalty should be set at 0.04%. The Chamber found that the assessor could not adequately justify that the imposition of 0.1% of the rent (25,000) on the tenant served to compensate the creditor's losses and would not result in unjust enrichment for the creditor, which the Chamber deemed contrary to the purpose of the penalty.

This decision is important from several perspectives:

First of all, it addresses the uniform court practice regarding the reduction of penalties, establishing the main criteria for such reductions. In addition, the decision is significant because in this case different instances of the court reached varying conclusions regarding the imposition of the penalty . The court of first instance reduced the amount requested from 27,175 GEL to 1,000 GEL, the Court of Appeal upheld the decision and determined that the breach of obligation was due to the non-payment of rent, serving as the evaluation criterion and this became the basis for evaluating the penalty imposed by the court. Meanwhile, the Supreme Court reduced the penalty amount requested by the party from 0.1% to 0.04%. In summary, the main principles upon which the court bases its reduction of the penalty are : proportionality, reasonableness, justice, and legality.

Conclusion

In conclusion, it should be noted that when the court determines an excessively high penalty, certain criteria should be taken into account, particularly, the degree and severity of the breach of obligation, as well as the reasons for the party's failure to fulfill the obligation, should be considered, since the failure to fulfill the obligation may be caused by objective reasons, the criteria established by judicial practice should also serve as a guide for all judges.

However, in making the assessment, the judge must strike a balance between the rights of the creditor and the debtor. It is not permissible to place only one party in a privileged position. The judge should exercise this discretionary authority only if the amount of liquidated damages stipulated in the contract is unreasonable, taking into account the reasons for the debtor's breach of obligation.

As a recommendation, it may be beneficial to establish a calculation rule for specific types of legal relations when determining reductions, in particular, in individual cases such as tender relationships, the judge may rely on recommendations indicating that a reasonable amount of liquidated damages is 0.02%. And as for the calculation method, it should be calculated not from the full value of the contract, but from the value of the unfulfilled obligation, since a breach of contract essentially falls on the party in cases of non-fulfillment or inadequate fulfillment of an obligation, therefore, it is logical for the judge to calculate the penalty based on the amount of the unfulfilled obligation rather than the total value of the contract.

The judge must observe the principle of contractual equilibrium and balance when reducing the penalty. While protecting the rights of the debtor, this should not come at the expense of the rights of the creditor, and vice versa.

Additionally, the application of Article 420 of the Civil Code of Georgia is crucial from the judge's perspective, as it helps prevent the abuse of rights by the creditor, who may set an entirely unreasonable amount in the agreement. Additionally, the Supreme Court's explanation regarding the principle that the creditor should not be unjustly enriched by the imposition of penalty is noteworthy.

Additionally, the following fundamental principles should be observed when the court reduces the penalty: proportionality, reasonableness, justice, and legality.

The judge must evaluate the interests of both parties to the contract, the reasons for the breach of obligation, and the ratio between the damage caused by the breach and the amount of penalty and this evaluation should be conducted based on the fundamental principles of legality and justice.

In this context, the experiences of foreign countries regarding the amount of penalty should be considered, and the parties should specify a reasonable amount of penalty in the contract.

The existence of the mentioned article in the Civil Code itself, which gives the judge the discretion to reduce the penalty, can be evaluated positively, because its existence contributes to the protection of the principles of legality and good faith in civil transactions and legal relations.

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