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*The Judicial Independence and
Legal Empowerment Project (JILEP)*

Assessment of ADR in Georgia

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I. Introduction

The object of this report is to analyze the current state of ADR in Georgia and make recommendations to assist JILEP programming in this area. Together with George Jugeli, JILEP's Commercial Law Advisor, and Sophie Tkemaladze, its ADR Advisor, I interviewed a number of judges, lawyers, arbitrators, academics and other informants and reviewed whatever existing studies we could find with respect to two forms of ADR in Georgia, arbitration and mediation. What follows is a summary of our findings and conclusions.

Initially, we expected the greatest opportunities for development to be with respect to arbitration rather than mediation, since Georgia has had a fair amount of experience in that area. Georgia enacted its first arbitration law in 1997, and then, in 2009, adopted a slightly modified version of the United Nations Commission on International Trade Law ("UNCITRAL") Model Arbitration Law, which is generally regarded as the international best practice standard. Furthermore, Georgia has a large number of institutions that administer arbitrations (referred to here as "Arbitration Courts"). On the other hand, while there appears to be a great deal of interest in mediation in Georgia, its development is still at an early stage of study and education.

As a result of our investigation, we have arrived at a conclusion which is the exact opposite of what we originally expected. As explained below, we believe that the prospects for developing mediation in Georgia are reasonably good since there is both a need, recognized by judges, lawyers and educators, and a potentially realizable model for promoting that form of ADR. On the other hand, as explained below, with the possible exception of certain limited areas, existing attitudes and institutions make the chances for developing a functional arbitration system in Georgia less promising.

A. Arbitration

There are a number of advantages which arbitration normally offers over litigation in court. For example, where a country's court system is corrupt or dysfunctional, arbitration may provide a fairer and more competent method of adjudication. In addition, arbitration is often faster and less expensive than litigation, it may allow for greater confidentiality and it can afford the parties opportunities to control the process and tailor it to their particular needs that are not available in court proceedings.

We found that a number of these possible advantages do not apply in Georgia. For one thing, arbitration was not perceived by many of our informants to be either fairer or more efficient than adjudication in the state courts. To the contrary, it appears to be widely distrusted and disfavored by many practicing lawyers in Georgia. This is due to the following circumstances, among others:

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- Under the prior, 1997 law, which allowed arbitration awards to be enforced without judicial confirmation, there were reportedly instances of fraudulent or collusive arbitrations which misappropriated property or otherwise violated the rights of third parties;
- In 2009 there were a number of highly publicized criminal prosecutions of arbitrators who had allegedly abused their position;
- The overwhelming majority of Georgian arbitrations today are brought by banks against borrowers who have signed contracts of adhesion providing for arbitration before private Arbitration Courts that are generally perceived to be under the control of the claimants.

The biggest problem appears to be that, unlike the U.S. and other Western countries, where arbitrations are normally administered by widely trusted non-profit organizations (like the American Arbitration Association in the U.S.), in Georgia the Arbitration Courts are for-profit companies that depend upon -- and therefore favor -- their “clients”, *i.e.*, the large institutions which select the Arbitration Court in their arbitration clauses.

On the other hand, while arbitration appears to be widely distrusted, the state court system is regarded as generally functional and fair. Thus, while judges are sometimes said to be subject to political or administrative pressure in cases where the state has a significant interest, most lawyers we spoke to thought the court system was impartial and competent in most cases between private businesses.

Finally, while arbitration is generally faster than litigation in court, in Georgia it is not less expensive. This is because the court fees for enforcing an arbitration award are roughly the same as those for litigating the case *ab initio* (3% of the amount in controversy subject to a GEL 300 minimum)¹. Therefore, since, in the case of arbitration, a party must pay both the fees of the Arbitration Court and the court fees, arbitration is actually the more expensive option.

In light of all this, not surprisingly, most of the lawyers with whom we spoke who were unaffiliated with banks or an Arbitration Court did not favor arbitration or recommend it to their clients. Furthermore, in order to change this situation, most of our informants believed that effective regulation and licensing of both arbitrators and Arbitration Courts would be required, as well as a change in the law with respect to court fees. In addition, in our view, the present system of having many, competing for-profit Arbitration Courts would have to be replaced by one, or a small number, of not-for-profit Arbitration Courts. Such fundamental reform is likely to be opposed by the existing Arbitration Courts and the “clients” and arbitrators who benefit from them (and, in the case of the court fees, by the state). Accordingly, the chances of effectuating such fundamental change appears remote. The only areas where some of our informants believed there might be a better chance to develop a functioning arbitration system were for international disputes on a regional level and perhaps for specialized areas like the construction industry.

¹ Under Art. 39 1, (a)2 of the Civil Procedural Code of Georgia, the court fee for an application for recognition and enforcement of an arbitral award is 3% of the value of award, but not less than GEL 300.

B. Mediation

We found a great deal of interest in mediation among judges, educators and lawyers. One appeals court judge with whom we spoke seemed particularly interested in mediation as a way of reducing the workload of the courts, and judges, lawyers and academics all saw mediation as a possible way for parties to save litigation costs and, equally important, preserve business relationships that might otherwise be destroyed by litigation. Some also expressed the view that mediation fits well with Georgian culture, which favors bargaining but disfavors litigation.

Also, as described in greater detail below, the ADR Center at Tbilisi State University (“TSU”) is already proceeding to develop, with JILEP’s help, a program of ADR education. They are about to begin an effort to “train the trainers”, i.e., to bring in foreign experts to train a select group of faculty members, who are also practicing lawyers, in mediation. Those faculty members could then teach students in this area as well as serving as mediators themselves. While the ADR Center had not yet developed a business model for institutionalizing mediation, which would obviously have to include some mechanism for compensating the mediators, their efforts could help in creating such a sustainable model in the future.

In addition, as is likewise described below, a possible model for a sustainable mediation program in Georgia may be provided by the mediation programs already instituted by the International Financial Corporation (“IFC”) in several of the former Yugoslav republics. As explained below, those programs, include, among other things

- getting judicial buy-in and sponsorship, including having courts suggest mediation to selected parties,
- having foreign mediation organizations and experts train local mediators,
- initiating a subsidized pilot program to demonstrate the efficacy of mediation,
- conducting educational efforts to familiarize the legal and business communities with the benefits of mediation, and, finally
- developing sustainable mediation programs in which the parties being benefited would bear the costs of mediation.

While the success of the IFC mediation programs in the Balkans should be independently verified, if they have in fact worked as well as the IFC materials indicate, they might well provide an example that could be adapted to local conditions and replicated in Georgia.

II. Description of the Investigation Conducted

Over the course of a week, we interviewed a number of persons affiliated with Arbitration Courts as well as judges, lawyers and educators and at least one purported organization of arbitrations. The following is a summary of what we learned:

Arbitration Courts

We spoke for about an hour with one of the largest, or probably the largest arbitration court in Georgia. In 2010-2011, they administered 550 arbitrations. 90% of the entities which select their Arbitration Court in arbitration agreements (as they refer “clients”) are banks or other financial companies. These banks won 100% of the arbitrations in 2010-2011, although they did not always get the full amount claimed. The biggest arbitration during 2010-2011 involved a claim for \$ 1.3 million, although on average their cases involved only \$ 5,000 - 10,000 claims. These arbitrations generally last 1-3 months, versus the year that a court case would take. Most of the respondents in arbitrations are individual borrowers. Georgian law does not provide bankruptcy protection for individuals, so such borrowers can wind up with life-long financial obligations as a result of these arbitrations.

Another arbitral institution we spoke to was smaller in terms of the number of arbitrations conducted (it had more than 10 cases in 2010 and 8 cases thus far in 2011) though it has larger arbitrations in terms of the claims amount. This arbitration court deliberately fosters this result by charging relatively high fees. Thus, their last two cases involved claims of \$4-5 million, and their smallest cases have involved claims for \$30,000-\$35,000. The “clients” include insurance, construction and development companies as well as banks. The Court has a closed list of 16-17 arbitrators; additional arbitrators may be considered but must be approved by the three partners who currently own Arbitration Court. In cases where a party fails to nominate an arbitrator the owners of the Court select an arbitrator for him.

In general the 2009 law was perceived by representatives of these arbitration courts as having had a positive effect by introducing more judicial supervision to prevent bad faith arbitrations. However, it was also perceived as having some negative effects. One example that was cited was a case this year in which a court had refused to enforce an award of one of these arbitration courts as contrary to public policy because one of the Court’s owners, who had not participated in the case, was also a partner of the Claimant. This arbitration court was considering introducing requirement of disclosure of such relationships before administering arbitration, in future.

In general it was believed that there was a need for mediation in Georgia, and that legislation would be helpful in that regard to ensure confidentiality, toll any applicable statutes of limitation and make the resulting settlement agreement binding.

Association of Arbitrations of Georgia (“AAG”)

Association of Arbitrations of Georgia claimed to have more than 55 organizations and more than 200 individual arbitrators as members. However, they had no list of their members and said their members do not pay dues. They said that they had carried out several projects with British and US agencies.

Law Firms

We interviewed partners of two law firms. Apart from one case, neither of the law firms had clients represented in domestic arbitrations. They said that their clients choose to litigate in court rather than arbitrate because they do not trust arbitration.

Several problems with arbitration were mentioned by these law firms. They felt that to have a workable system of arbitration in Georgia there would have to be a change in the mentality of the business community. They said that Georgia is a small country in which everyone knows each other, and clients fear that arbitrators will talk to their friends about their cases. Often Arbitration Courts had been created by law firms and were generally used by banks and real estate companies. They also mentioned that the numerous reports of arbitrators being arrested had hurt the reputation of arbitration. They also had an issue with the competency of available arbitrators. The unavailability of any meaningful appeal in arbitration was also perceived to increase the risk of a wrong result.

They stated that the new arbitration law was an improvement since, under the old law, arbitration decisions often went beyond the competence of the arbitral tribunal, but the awards were already in force by the time they were reviewed by a court. One case that was mentioned was a domestic arbitration under the old law in which a client of one of these law firms had taken out a bank loan. The bank in that case was represented by the owner of the Arbitration Court. The client wound up having to pay not only the debt with interest, but also compound interest, which our interviewee said was contrary to Georgian law. A problem with the new law that was mentioned is the possibility of an award being set aside based on “public policy”, a standard which was not yet defined. That lawyer then showed us a recent decision in which a court had set aside an award which included a penalty for late payment of 0.2%/day (72%/year), which the court reduced to 0.07%/day.

In general, these lawyers thought that arbitration in Georgia required more regulation, including some kind of certification procedure and an enforceable code of ethics for arbitrators. They also questioned whether the local Georgian market was sufficient to support an arbitration system and suggested that a regional arbitration center covering Armenia and Azerbaijan as well as Georgia might do better.

With respect to mediation, while both law firms understood and favored this form of ADR they were not sure whether that would work in Georgia. It was noted that most companies were not even aware of when they needed a lawyer, and were thus unlikely to seek the help of a mediator. It was suggested that to work in Georgia the concept would have to be adopted into a law and the courts would have to incentivize the parties to mediate.

The Business Association of Georgia (“BAG”)

We spoke with some representatives of the BAG.

One, a former judge, who was also involved with one of the Arbitration Courts believed that the 2009 law had improved arbitration, in particular by requiring judicial recognition before an award can be enforced. She noted that under the old law there were many unqualified arbitrators, some of whom had been sent to jail. When asked about one Arbitration Court in which the banks had won 100% of their cases in 2010-2011, she pointed out that the banks also generally win these cases in court. It was also mentioned that under the new law, judges have

too much discretion to set aside or modify arbitration awards as being contrary to “public policy”. An example of such discretion was a case in which an award was reduced because the “fine” (i.e. penalty) for late payment was deemed excessive.

Another representative, who is a partner in a prominent law firm, said that his clients do not use arbitration. He said that prior to 2009, several Arbitration Courts had emerged which were limited to handling arbitrations for banks, insurance companies and construction firms. His experience was that the arbitrators lacked qualification. He also said that there was a surfeit of Arbitration Courts. He said that his clients would choose arbitration if the arbitrators were qualified, there was no corruption and the process was faster and cheaper than court litigation. However, his clients were generally satisfied with the state courts and found the judges to be independent in civil cases. He also said that while arbitration was speedier than court litigation it was not cheaper since the law on court fees provides for the same 3% fee for recognizing an arbitration award as it does for litigating the case in its entirety.

It was suggested that clients might use arbitration if it was more focused. For example, businesses might be encouraged to use arbitration in construction cases if the arbitrators were lawyers or engineers knowledgeable in that field. It was also noted that some clear decisional law as to when arbitration awards will be set aside as contrary to public policy, would be helpful.

With respect to mediation it was noted that Georgia was ready for mediation to be introduced and that clients would welcome having access to mediation experts. The need for a mediation statute like the UNCITRAL Model Law that would provide, for example, for confidentiality, was emphasized.

Ministry of Justice

We spoke with a representative of the Department for State Representation in Arbitration and Foreign State Courts of the Ministry of Justice. The department is involved exclusively with defending the State of Georgia in international arbitrations and litigations. Accordingly, the representative had no real experience with domestic arbitration or civil litigation in Georgia.

As for mediation, she noted that Georgia lacked a culture and of working system of mediation. It was noted that mediation would be helpful in international cases since it would be a way to preserve relationships, e.g. with foreign investors. Due to the lack of qualified mediators at this stage it was thought to be unreasonable to require mediation as a prerequisite for domestic litigation.

High Council of Justice

We met with Judge Valeri Tsertsvadze, Secretary of the High Council and Chairman of the Tbilisi Court of Appeals. Judge Tsertsvadze regarded mediation as very important and was extremely eager and proactive with a number of plans in process to help his court learn from the U.S. and European experience. We came away with the strong impression that he and the High Council could be a potential partner in implementing a well-thought out mediation program.

As for arbitration, Judge Tsertsvadze thought it lacked appeal for many parties because they still had to go to court to confirm their awards, which also means more work for the courts. He also thought there were problems with the qualifications and impartiality of arbitrators, and that licensing might be a good solution (although implementing that was a job for Parliament

rather than the courts). He also helped our team by arranging for us to get copies of Court of Appeals decisions confirming or setting aside arbitration awards.

Tbilisi State University/ADR Center

We met with Dr. Irakli Burduli, the Dean of the Law faculty, and Prof. Dr. George Tsertsvadze, Acting Director of the ADR Center. The goal of the Center was to develop mediation as an institution in Georgia. In that regard, they are partnering with the Technical College of Law and cooperating with South Texas School of Law and Pepperdine Law School. Dean Burduli thought that mediation fit well with the Georgian culture, which dislikes going to court but likes to bargain. Among the initiatives planned are:

- obtaining a charter as the legal basis for Center's activities
- promoting the enactment of a mediation law
- embarking on a pilot program to train judges in mediation
- training 4-5 faculty members who are also practicing lawyers as mediators and teachers of mediation
- developing a model for teaching mediation skills, and
- establishing a research/resource center on mediation.

While Dean Burduli envisions a program which would use selected TSU faculty members as mediators, a business model for a sustainable mediation center which would provide, inter alia, for compensating mediators, is not yet developed.

Mr. Boris Janjalia (IFC/ADR Expert)

Mr. Janjalia's particular interest is in corporate governance-related ADR. However, the IFC had also begun a project to develop mediation in Georgia and, in that connection, they had met with representatives of the courts and the Ministry of Justice. He indicated that the judges seemed interested in mediation as a way of reducing their work loads. However, as soon as the USAID initiative emerged, IFC put their own project on hold to avoid a duplication of effort. He also mentioned that Georgia had a program of mediation involving juvenile criminal offenders and their victims, although he was vague as to exactly how this worked.

Of particular interest, Mr. Janjalia told us about an IFC mediation program in Montenegro where an ADR center was created with the involvement of the judiciary. Initially, the mediators were judges who were incited to serve without further compensation by the hope of achieving settlements and thereby reducing their work loads. However, the project now has 30 private part-time mediators. The Center uses the premises of the Ministry of Justice and the parties now pay the mediators for their services. The result, after 4 years, is a sustainable, self-supporting mediation program. A similar project is also underway in Bosnia and Herzegovina. Both these former Yugoslav republics have adopted the UNCITRAL Model Law for mediation, which provides for confidentiality and other matters. Another, less successful program is underway in Serbia. In all these countries, the judges and mediators have been trained by foreign mediation experts from the UK and the Netherlands.

With respect to arbitration, Mr. Janjalia mentioned that the new law sometimes permits courts to go too far, e.g., in some cases cutting the fees awarded to the arbitrators. He also said that serious arbitrators agree that there is a need for some regulation of arbitration and a certification system for arbitrators in Georgia. On the other hand, while Georgians tend to look at the courts with suspicion and there is talk that judges are not independent and are subject to pressure, that has not been his experience.

Written Materials

One interesting commentary on arbitration in Georgia that we read before commencing our interviews was a Technical Report prepared in 2007 by the Austrian arbitration expert, Dr. Peter Binder, for the Georgian-European Policy and Legal Advice Center (GEPLAC), entitled “Advice on the implementation of legislation in the area of commercial arbitration.” *See also* Binder, Comments on the Draft Georgian Arbitration Law, Georgian Law Review 10/2007-2/3. Dr. Binder’s commentary was written while Georgia’s 1997 arbitration law was in effect and the 2009 law was still a draft bill being considered by the Legal Committee of the Georgian Parliament. At that time Georgia had just tried arbitration in tax cases, an experiment that was abandoned after the government lost a multi-million Lari award in the so-called “Telassi” case. While Dr. Binder devoted much of his commentary to a section-by-section analysis of the Draft Arbitration Act, he identified the following more general problems with arbitration in Georgia, for which he proposed the following solutions to establish trust and credibility in arbitration as an institution:

- Lack of knowledge/awareness of arbitration (it was estimated that only 20% of Georgian businessmen even knew of the existence of arbitration). Dr. Binder suggested a broad information campaign to remedy this;
- Bad publicity due to the tax arbitration debacle. Dr. Binder suggested a wide-ranging media campaign to promote the new arbitration act;
- The supposed low quality and education of Georgian arbitrators. Here Dr. Binder suggested training for potential arbitrators on a professional level;
- A surfeit of Arbitration Courts in Georgia (Dr. Binder identified 25 of them). Dr. Binder recommended that a lower number of higher quality Arbitration Courts be established, a goal that he suggested might be achieved by regulation and licensing. Interestingly, Dr. Binder suggested that the Georgian Arbitrations Association might play an important role here since all the Arbitration Courts are members (as noted above, we found that the Association now appears to be effectively defunct.)
- Fears of abuse. Here, Dr. Binder recommended implementing international best practices and judicial supervision to counter cases of arbitrator misconduct.

In addition, while in Georgia I was also able to read Dr. George Tsertsvadze’s Max-Planck-Institute thesis, “Recognition and Enforcement of Foreign Arbitral Awards in Georgia”. While not directly on point with respect to our investigation of domestic ADR in Georgia, Dr. Tsertsvadze’s work provides a rich source of information on arbitration in Georgia. In addition,

as noted above, we also spoke with Dr. Tsertsvadze in his capacity as Director of the ADR Center at TSU.

Finally, we reviewed an IFC brochure which described the mediation programs they have been introducing since 2003 in the Western Balkans – Albania, Bosnia and Herzegovina, FYR Macedonia, Montenegro, and Serbia. At the time those ADR programs began, companies seeking to resolve disputes through litigation faced average wait times of 501 days and thirty to forty bureaucratic procedures prior to resolution of the dispute. Backlogs in regional courts were substantial: in Bosnia and Herzegovina, there were 15,625 cases per court. Against that background, IFC began two pilot projects in Bosnia and Herzegovina in 2003, followed by two more in Serbia in 2004, and then expanded the project across the region. The project included drafting mediation laws and regulations in accordance with the UNCITRAL Model Law and European Union recommendations, collaboration with the national Ministries of Justice and other key stakeholders to enact the program, and training sessions to develop local mediators and mediator trainers. In total, between 2004 and 2009, IFC established eighteen mediation centers, which have resolved 3,011 cases through mitigation, releasing \$100.1 million in disputed assets and settling the mediated cases in an average of 28 days. The IFC is now rolling out similar projects in Ukraine, Egypt, Morocco, Burkina Faso, Pakistan, Bangladesh, Cambodia, Papua New Guinea, Vanuatu, and Tonga.

III. Analysis of Arbitration in Georgia

A. The Legal Framework

The 1997 Law

The first legislation on arbitration in Georgia was the Law on Private Arbitration (1997). This was a first attempt by Georgia to depart from the Soviet type “Arbitrazh” courts, which were not arbitration courts at all but rather state courts that handled commercial matters. However, the 1997 law was far from the international best practice standard. Some of its shortcomings that led to significant abuses were the following:

- Art. 42 of the Law empowered the chairman of an arbitration panel to issue an enforcement order within 5 days after a party’s request. Thus, arbitral awards were subject of enforcement without any judicial review. In practice this resulted in cases of abuse of the power by arbitrators and fraudulent arbitrations. For example, in one frequently mentioned case, an arbitrator rendered an award in a dispute between two brothers regarding real estate that actually belonged to a third party. As a result, one of the brothers obtained an award giving him ownership of the third party’s property. It was allegedly commonplace for parties to initiate such fictitious or collusive arbitrations as a means of obtaining rights over property belonging to a third party, who would not even be notified of the arbitral proceedings. In another case which was mentioned by several of our interviewees an arbitrator supposedly gave a child up for adoption.
- Article 7 of the Law required that all permanent Arbitration Courts be registered as commercial entities (LLC’s) pursuant to the Law of Georgia on Entrepreneurship. This requirement has led to the situation existing today, in which a multitude of for-profit Arbitration Courts have been established in the form of LLC’s. As described below, these Arbitration Courts compete with each other for “clients”, i.e., large institutions that will name the Arbitration Court in their arbitration agreements. This dynamic had the effect of making the Arbitration Courts increasingly partial in favor of the “clients” whose business they are trying to attract or keep.²

The 2009 Law

In June 2009, the Georgian Parliament adopted a new Law on Arbitration, which largely follows the UNCITRAL Model Law on International Commercial Arbitration and thus brings the Georgian legal framework in line with international standards.³ The Law designates the courts

² Two other drawbacks of the 1997 law were Art. 43, which gave courts the power to “change” awards, without spelling out the possible bases or scope of such authority; and the unreasonably short (one month) time limit for rendering an award.

³ The 2009 law does however depart from the UNCITRAL Model Law in some respects. For example, in cases where the party to an arbitration agreement is a natural person or an administrative agency, the law requires the arbitration agreement to be in writing. Also, while the New York Convention and the Model Law require courts to refer the parties to arbitration in
(continued...)

with jurisdiction for the recognition and enforcement of awards, which, in cases of international awards, is the Supreme Court of Georgia, and, with respect to domestic awards, the Courts of Appeals. It closely resembles the Model Law and the New York Convention regarding the grounds for setting aside or refusing to recognize and enforce arbitral awards. One of these grounds, which has been the subject of some controversy, is the “public policy” exception, under which courts may set aside or refuse to enforce awards if they are found to be contrary to “public policy” or “public order”. As noted above, many of the practicing lawyers and Arbitration Court owners with whom we spoke were of the view that the courts of appeal had been overly liberal in applying this standard to review and revise arbitration awards with which they disagreed on the merits.

In order to test the validity of this criticism, we reviewed the following court of appeals decisions:

- In *BasisBank v. Kapanadze*, Case No. 2b/1604-11 (Tbilisi App. Ct. May 31, 2011), the Court of Appeals found that a penalty for late payment of 0.1% per day (36.5%/year) was “inappropriately high”. The Court invoked Art. 420 of the Civil Code of Georgia, which authorizes the Court, taking into consideration the specific circumstances of the case, to reduce an inappropriately high penalty. Accordingly, it found the penalty to be contrary to public policy and reduced it to 2% for each month of late payment.
- In *Bized Holdings Georgia v. Dematrashvili*, Case No. 2b/2747-11 (Tbilisi App. Ct. Sept. 12, 2011), the Court of Appeals refused to enforce the award that obliged the borrower to pay a penalty for late payment in the amount of USD 180 per day. The Court held that the penalty was “contradictory to fundamental principles of the law of obligations, i.e. to public order”, and reduced it to USD 30 per day.
- In *LTD “Credit Plus” v. Gela Zarkua*, Case No.2b/1596-11(Tbilisi App. Ct. June 21, 2011), a Court of Appeals found that a penalty for late payment of 0.1% per day was not contrary to public policy and granted recognition and enforcement of the award.
- *Medinservice v. Best Pharma and Vasileva*, Case No. 2b/987-11 (Tbilisi App. Ct. Mar. 31, 2010), concerned recognition and enforcement of an award under which the defendants were ordered to pay the value of the goods purchased plus compensation for lost profits in the amount of 2% of the value of the goods per

matters which are subject of an arbitration agreement, Art. 9.1. of the 2009 Law requires such referral only after commencement of the arbitration hearing. The Code of Civil Procedure of Georgia, on the other hand, expressly provides that the very existence of an arbitration agreement covering the dispute is a ground for either dismissal or termination of court proceedings. Another departure from the Model Law is Art. 44 of the 2009 Law, which empowers a court to suspend recognition and enforcement of an award upon the request of a party which provides appropriate security. The Model Law, in contrast, allows for such suspension only in more limited circumstances, such as when the award has been set aside or suspended by a court in the country where it was rendered.

month. The Court found that there was nothing in the parties' agreement that justified this additional charge for late payment, and held that the charge was "contradictory to fundamental legal principles governing the law of obligations and, consequently, to public order".

- In *Debt Recovery and Management Group v. Alliance Group Capital*, Case No. 2b/2130-11 (Tbilisi App. Ct. July 20, 2011), a Court of Appeals held an arbitration award to be contrary to "public policy" for a different reason. There, the Court found that the fact, that a person who owned 67% of shares in the Claimant's corporation also owned 16.65% of shares of the Arbitration which rendered the award, created a conflict of interest rendering the arbitration award unlawful. The Court noted that, although there was no definition of "public order" in the statute, the logic of this provision suggested that it should cover such a substantial violation of a party's right to have his case reviewed by an independent and impartial arbitrator. Finding that the facts before it gave sufficient ground for doubt as to the impartiality of the Arbitration Court, the Court refused recognition and enforcement of the award as being contrary to "public order".

While, as noted above, cases such as these were criticized by a number of the attorneys and arbitrators with whom we spoke, including especially (but not exclusively) those affiliated with Arbitration Courts, in fact most if not all of the awards for which enforcement was refused do seem to involve cases of oppression or manifest unfairness.

Furthermore, these decisions are not in fact at odds with international practice. It is true that, in the U.S., courts are generally prohibited from reviewing the merits of arbitral awards, even when the size of an award is "either shocking or unsupported by the record." *Lagstein v. Certain Underwriters at Lloyd's, London*, 607 F.3d 634, 641 (9th Cir. 2010). Nevertheless, U.S. courts have set aside arbitral awards as contrary to public policy where that policy is "explicit, well defined, and dominant. . . [and] ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interests." *Id.* at 62 . Such a public policy is embodied, for example, in state usury and similar laws. In New York, for instance, the maximum annual interest allowable under the civil usury statute is 16% and the maximum annual interest under the criminal usury statute was 25%; and contracts providing for interest in excess of such amounts have been held to be void. *See Funding Group, Inc. v. Water Chef, Inc.*, 852 N.Y.S.2d 736, 740 (N.Y. Sup. Ct. 2008); *see also id.* at 742 (declaring void as a matter of law a loan with a combined annual interest rate of 363% as exceeding the state usury limits).

With respect to the Court of Appeals decisions discussed above, we also heard the view expressed that the courts may have been influenced by a suspicion of the arbitration process based on the kinds of reports of past abuses we had heard from various sources, compounded by a concern that the Arbitration Courts may not be impartial and that arbitration in many of these cases was the result of contracts of adhesion rather than truly voluntary agreements.

In fact, most of the criticism of this aspect of the current law in Georgia that we heard from independent lawyers was not so much that these decisions reached the wrong results, as that they provide inadequate guidance going forward as to when an award will be found to violate public policy. That situation may be remedied as the case law develops, provided of course that

these decisions of the courts of appeals become more readily available to practitioners (preferably, on-line).

Georgia Civil Procedure Code

Another aspect of the current law which was the subject of a lot of criticism by the informants we interviewed is Art. 39 1 (a)² Georgia's Civil Procedure Code. This provision sets the court fee for an application for recognition and enforcement of an arbitral award at 3% of the value of the award, subject to a minimum charge of GEL 300. As noted above, when added to the fee of the Arbitration Court, this high court fee generally makes arbitration more expensive than court litigation.

Conclusion

In sum, while there are certainly some aspects of the current statutory framework that could be improved -- especially the 3% fee for recognition and enforcement of an arbitration award -- in our view, the more serious problems with arbitration in Georgia lie elsewhere, e.g., with the current system of competing for-profit arbitration courts, and the lack of effective regulation.

B. Regulation of Arbitrators

There is currently no meaningful regulation with respect to qualifications or a code of conduct for arbitrators in Georgia. The absence of an enforceable code of ethics and of a reasonable mechanism for policing, or self-policing, the conduct of arbitrators, was considered by many of our informants as a major gap with the present legal framework. A number of our interviewees thought that a code of ethics and a system for the certification of arbitrators would raise the level of their professionalism and qualifications. Likewise, publishing lists of arbitrators who had been duly certified (or disqualified) could help make arbitration a more reliable and trusted method of dispute resolution.

Thus far, however, the one way in which arbitrators have been policed and held liable has been through criminal prosecution. In 2008, the Parliament introduced changes in the Criminal Code of Georgia whereby arbitrators became equivalent to public officials for the purposes of the criminal laws concerning abuse of public office. Thus, arbitrators became subject to prosecution for, among other things, "abuse of public authority" (CC Art. 332), "exceeding their authority" (CC Art. 333) and "indifference to the public office" (CC Art. 342). According to our interviewees, while some of the arbitrators that were prosecuted probably had in fact misused their authority, these provisions of the criminal code were also sometimes applied in cases where an arbitrator had merely erred in deciding a case and/or where there was a political motive for the prosecution. We could not come to an informed judgment of our own about these prosecutions since we have thus far not been able to obtain any official records regarding the cases. However, such criminal prosecutions would seem likely to adversely affect the independence of arbitrators and, indeed, the willingness of some arbitrators to serve at all.

C. The Problem of the For-Profit Arbitration Courts

As indicated above, most if not all of the Arbitration Courts in Georgia are for-profit legal entities (mainly LLCs). This appears to be a legacy of the Law on Private Arbitration of 1997, under which a permanent arbitration institution was allowed to commence its activities

after its incorporation according to the rules of the Law of Georgia On Entrepreneurs (1994 as amended). That law regulates the establishment and activity of commercial (for-profit) entities. The result appears to be the prevalence today for-profit Arbitration Courts in Georgia.

We found that these for-profit Arbitration Courts regarded the institutions which named them in their arbitration clauses as their “clients” (a term they continually used), and they competed for such “clients” with other Arbitration Courts. In our view, the inevitable result of this “client-service provider” relationship is that the Arbitration Courts are motivated to try to please their “clients”, on whom they depend for their business generation and profits. On the other hand, the Arbitration Courts do not have to worry about pleasing the borrowers and other contract parties which are generally the respondents in their arbitrations since those parties are normally before a particular Arbitration Court, not out of choice, but because they had to sign a contract of adhesion naming the “client’s” chosen forum.

It seems obvious that the kind of service most likely to please an Arbitration Court’s “clients” would involve dependable, successful results, achieved quickly. It therefore is not surprising that, for example, at one Arbitration Court which we visited, where 90% of the “clients” are banks and financial companies, the banks win 100% of the cases in extremely expeditious arbitrations. What is more, in this environment, competition, far from promoting consumer welfare, instead has the perverse effect of driving the Arbitration Courts to become more and more partial in favor of their “clients”. The absence of any regulation of the Arbitration Courts (except perhaps the possibility of criminal prosecution) leaves the potential for abuse virtually unchecked. The result is that the Arbitration Courts and arbitration in general, are widely distrusted and disfavored.

This system of for-profit Arbitration Courts in Georgia departs significantly from the international best practice standard. In the United States, for example, Arbitration Courts are generally widely-respected not-for-profit institutions, such as the American Arbitration Association. Their roots lie in voluntary organizations of businessmen, who created such systems to resolve disputes within their communities. Arbitration under the auspices of the New York Chamber of Commerce dates to 1768, and has continued in various combinations to the present day. *See* William Catron Jones, *Three Hundred Years of Commercial Arbitration in New York: A Brief Survey*, 1956 Wash. U. L. Q. 193, 207, 211-212 (1956). In 1926, the American Arbitration Association – a non-profit institution – was founded by the merger of the two young arbitral associations, the American Arbitration Foundation, established by the New York Chamber of Commerce, and the Arbitration Society of America, itself founded by reformers who sought to expand the use of arbitration nation-wide. *See* Ian R. MacNeil, *American Arbitration Law: Reformation, Nationalization, Internationalization* 40-41 (Oxford U.P. 1992). In our view, Georgia would need some similar structure of not-for-profit, neutral Arbitration Courts, supervised by adequate regulation, in order to gain the trust and confidence necessary to make arbitration work as an institution.⁴ Doing that, however, would involve the formidable task of

⁴ One area where arbitration in the U.S. was reformed in response to criticism for being biased in favor of an industry involves disputes between securities investors and brokers. These cases are currently arbitrated under the auspices of the Financial Industry Regulatory Authority (FINRA). When a dispute is submitted to arbitration, FINRA’s Neutral List Selection System – a computer algorithm – generates a random list of arbitrators for the parties’ consideration. The names and biographies of the potential arbitrators are sent to the parties, who can then each strike a certain

(continued...)

dismantling the present system of for-profit Arbitration Courts as well as introducing a regulatory scheme that would prevent abuses without, however, subjecting the Arbitration Courts to political pressure or influence. As indicated below, it is by no means clear that all this could be accomplished.

number of arbitrators from serving, and who then each rank the remaining arbitrators in order of preference. The parties' preferences are then combined to either select the sole arbitrator who will serve, or to generate an arbitral panel. A sole arbitrator is always "public", i.e., not affiliated with the securities industry. Investors can choose to have the dispute heard by three public arbitrators, or else by default it will be heard by a panel of two public and one non-public (i.e., securities industry affiliated) arbitrators.

These processes for choosing arbitrators are a result of SEC-supervised reforms enacted in part to resolve complaints of partiality and bias documented in a report entitled *Securities Arbitration Reform: Report of the Arbitration Policy Task Force to the Board of Governors of the National Association of Securities Dealers* (1996) ("Ruder Report"). The availability of all-public arbitral panels in particular is a reform introduced after hearings before the House of Representatives in which "investor advocates complained that the system was unfair, inefficient, expensive, and biased toward industry," while the representatives of the securities industry defended the efficacy and fairness of the process. See Jill I. Gross, *McMahon Turns Twenty: The Regulation of Fairness in Securities Arbitration*, 76 U. Cin. L. Rev. 493, 497 (2008).

IV. Analysis of Mediation in Georgia

Mediation does not currently exist as an institution in Georgia, and there appears to be little information as to how mediation works in other countries. However, as indicated in the above report of our meeting with Judge Valeri Tsertsvadze of the High Council of Justice, there appears to be a great deal of interest in mediation in the judiciary, which sees it as a potential tool to reduce the case load of judges. In addition, as described above, the ADR Center at TSU has, with JILEP's assistance, embarked on an active program to train faculty members in mediation and create an information and education center devoted to mediation. What seems to be still missing at present is a workable business model for creating a sustainable system of mediation in Georgia

Such a model might be developed based on the example of the IFC mediation programs in the Balkans. As described in the IFC's materials, those programs appear to include the following key elements:

- Collaborative partnerships with national ministries of justice and courts, some of which eventually refer parties in selected cases to mediation;
- The use of foreign mediation experts to “train the trainers”, who in turn can train a cadre of skilled local mediators, and to educate judges to understand mediation and select cases in which mediation may be useful;
- The adoption of laws on mediation in accordance with the UNCITRAL Model Law on International Commercial Conciliation and European Union recommendations, and procedural regulations to allow improved access to mediation;
- A subsidized pilot program to establish a track record and demonstrate the benefits of arbitration;
- Promoting demand for mediation through public awareness campaigns and the education of local judges, attorneys and businessmen as to the benefits of mediation; and
- Establishing commercially viable, sustainable mediation centers in which the parties benefitting from the service would generally pay fees to compensate the mediators and cover administrative costs.

See International Finance Corporation, Giving Mediation a Chance: Telling Our ADR Story: Alternative Dispute Resolution Program in the Western Balkans, at 19 (June 2010).

The effectiveness of the IFC programs should be independently verified, e.g., by JILEP or USAID, in the various countries in which they are operating. Assuming that the programs were found to be effective, a program could be developed to adapt the model to local conditions in Georgia and implement a program in collaboration with local stakeholders, including the judiciary and High Council of Justice, the Ministry of Justice, the ADR Center at TSU, local lawyers and business organizations, and other interested parties.

Conclusions and Recommendations

As explained above, the prospects for developing arbitration in Georgia do not appear promising. There does not seem to be any great demand for arbitration among lawyers, the business community or the courts. This is in part due to the fact that arbitration has developed a poor reputation and is therefore distrusted and disfavored, while the state court system is viewed as generally functional and fair, at least in cases in which the government does not have a direct interest. At the same time, while arbitration may be somewhat more expeditious than court litigation, it is also more expensive due to the high court fees imposed for recognizing and enforcing an award.

What is more, reforming arbitration would be difficult. Since the main problem is not with any statute, reform (aside from perhaps reducing the fee for court recognition of an award) cannot be accomplished simply by amending a law. Rather, what would appear to be required is the wholesale replacement of the current system of for-profit Arbitration Courts, often controlled by a particular group of “clients”, with a new regime characterized by a single, or small number, of widely-respected, not-for-profit Arbitration Courts, combined with an effective system for regulating, vetting and certifying both arbitrators and Arbitration Courts. Since such a fundamental reform is likely to be opposed by the owners of the current Arbitration Courts -- who were the only people we talked to who seemed enthusiastic about arbitration --it would appear that any such reform effort would be an up-hill fight that is unlikely to succeed. While some of our informants suggested discrete areas in which arbitration might succeed -- e.g., international arbitration on a regional level and construction disputes -- if there is really a market for such specialized arbitration courts, one would expect them to develop, at least initially, on their own, without outside help or funding.

Mediation, on the other hand, appears to be a form of ADR for which there is a great deal of interest and potential demand in Georgia. As noted above, we found such interest not only among practicing lawyers and academics, but also in the judiciary and Ministry of Justice. The IFC programs in the Balkans appear to offer a possible model that might be adapted to the situation in Georgia. Therefore, we would suggest, as a next step, that JILEP investigate and confirm the efficacy of these IFC programs. If they are as successful as the IFC reports indicate, JILEP could develop a proposal to adapt and implement the IFC model in Georgia. In this connection, JILEP could build upon what it is already doing with the TSU ADR Center. In particular, JILEP might develop and then discuss with the various stakeholders, including the courts, the High Council of Justice, the Ministry of Justice, the bar and business organizations, a proposal for a sustainable mediation program that would involve the active participation of all these institutions and groups.