

Termination of the Contract and Obligation in General

Zurab CHECHELASHVILI*

Abstract

The article briefly examines the main legal issues regarding the grounds for termination of an obligation under the Georgian law. In addition to the performance of the obligation, the Civil Code of Georgia and the Georgian legal theory, on the basis of the German Civil Code and the German legal science provide other grounds for termination of the obligation, namely, novation, deposit, set-off, remission of debt, confusion, death of debtor or creditor and winding-up of a legal person, impossibility, frustration.

Keywords: confusion, frustration, novation, performance, remission of debt, set-off

Introduction

The obligatory contracts are usually made for the definite period of time and sooner or later they will be terminated. As a result, the obligatory relation existing between the parties on the basis of a contract shall also be terminated. However, termination of the obligation may occur not only by performance of the obligation despite that the latter was the primary purpose of the contracting parties at the moment of conclusion of the contract; in fact, performance is the most desirable ground for termination but it is not the only one. There are *other grounds for termination of the obligation* in the civil law as follows:

1. Performance of the obligation;
2. Novation;
3. Deposit;
4. Set-off;
5. Remission of debt;
6. Confusion;
7. Death of debtor or creditor and winding-up of a legal person, etc.

Performance of the Obligation

Any kind of performance of the obligation does not result in the termination of the obligation; performance should be proper. Besides, it is not sufficient for the performance that the debtor merely carries out all the necessary operations for it. The result of the performance is deciding and not just the action for performance; it is the only way by which the creditor's interests can be satisfied. If the debtor did everything for transferring the thing subject to obligation but the creditor nevertheless did not accept it the obligation is not deemed fulfilled. In this case the law provides protection of the interests of the debtor by determining the provisions of default of the creditor. (Brox, 2007, p.124).

It is disputable in the German legal science whether the special so-called "performance agreement" must be made for the performance of the obligation. The German Civil Code has delegated the answer to the question of the legal nature of performance to the legal science in which there are two different theories:

1. *the old so-called "agreement theory"* in all cases except

the purely actual performances, specifies the conclusion of the performance agreement;

2. more acceptable is *the modern "real performance theory"* which is dominant in the German legal science. This theory specifies as performing act only the achievement of the result of the performance. (Brox, 2007).

The law obligates the creditor to issue at the request of the debtor *a document confirming the full or partial performance of the obligation*. Besides, the law provides also the *certain adverse effect* for the creditor in case of his refusal to carry out this obligation. In particular, in accordance with the Article 433 of the Civil Code of Georgia, if a creditor refuses to issue a document on the receipt of performance, or to return or cancel the document of indebtedness, or to indicate in the document on receipt of performance that return of the document of indebtedness is impossible, or to acknowledge that the debt is extinguished then the debtor shall be entitled to refuse to perform the obligation. In such cases the creditor shall be deemed to be in default. In addition, the debtor is protected with the legal presumption, according to which if a document drawn up to confirm payment of a debt does not indicate to the interest it is presumed that the interest has been paid and the pecuniary obligation is terminated (Brox, 2007).

Novation

The parties can agree on the termination of the obligatory relationship already existing between them by creating the new one on its place. Such agreement is known as *novation* in the civil law. But the question is as follows: where, in which article can we find such a ground for termination of the obligation in the Civil Code of Georgia?

Until 2002 the Georgian legal science mistakenly believed that the provision establishing novation was the Article 428 of the Civil Code of Georgia, the initial wording of which was as follows:

"Article 428. Termination of an Obligation by Novation.

The obligation also expires if the creditor accepts, in lieu of performance as provided by the obligation, the performance other than that owed (novation)". (Brox, 2007).

* Prof., Faculty of Social Sciences, International Black Sea University, Tbilisi, Georgia.
E-mail: zchechelashvili@ibsu.edu.ge

As it is obvious from the text of this article, the *provision indicates to the performance other than that owed in lieu of performance under the contract*. This article is analogous to the part 1 of par. 364 of the German Civil Code but neither the authors of the German Civil Code nor German legal scientists regarded (and will never do that in the future!) the provision of part 1 of par. 364 as novation: German scientists unanimously recognise that this paragraph provides just the performance other than that owed in lieu of performance as provided by the obligation and not – novation (*“Annahme an Erfüllungs statt”*); the latter, on the contrary, provides termination of one obligation and creating the other obligation on its place and is put into part 1 of par. 311 of the German Civil Code (German Civil Code, paragraph 364). By the law of 28.12.2002 the above defect has been eliminated by the Georgian legislator and Article 428 was corrected in full compliance with the wording of part 1 of par. 364 of the German Civil Code:

“Article 428. Termination of an Obligation by Acceptance in lieu of performance

The obligation also expires if the creditor accepts, in lieu of performance as provided by the obligation, the performance other than that owed”. (Civil Code of Georgia, 2002).

Well, if it turns out that Article 428 does not provide the novation the question still remains: where this ground for termination of obligation is provided in the Civil Code of Georgia? Unfortunately, such *provision does not exist at all* since the provision similar to part 1 of par. 311 of the German Civil Code – Article 319 of the Civil Code of Georgia (“The parties of private law are free to enter into contracts and determine their content within the scope of the law”) indicates to only entering into contracts or determining their content and not – to changing the content as it is referred in par. 311 of the German Civil Code (“sowie zur Änderung des Inhalts eines Schuldverhältnisses” – “as well as for alteration of the content of an obligation”).

Since the old obligatory relationship is totally replaced by new one, *the security rights* which have been created for the old obligatory relationship are cancelled. Additionally, the pleas under the old obligatory relationship are no more admissible. Whether the parties mean the novation or something else must be determined as a result of construction of the agreement. As far as the creditor does not wish to cancel the existing security and the debtor – to lose the pleas the parties usually intend to make *so-called “amendment agreement”* and not the novation itself. In case of the amendment agreement the obligatory relationship is changed by the agreement between the creditor and debtor, which is in full compliance with the principle of freedom of contracts. The amendment may relate to the principal obligation as well as to the auxiliary obligations. If the claim is reduced partial remission of debt occurs and, consequently, – the disposition (disposition transaction). If the claim is increased or new claim has arisen the amendment of the content shall be deemed as the obligatory transaction. Since the obligation is only amended the security rights created for it shall be preserved and the debtor can apply the pleas existing against the old obligation.

Deposit

The Civil Code of Georgia enables the debtor to release himself from the obligation before the creditor when the latter delays acceptance of the performance or his address is not

known. In accordance with the Article 434 of the Civil Code of Georgia, the debtor is entitled to place the object of performance on *deposit* with a notary public or court, and deposit the money or securities to the deposit account of a notary public.

For release from the obligation by deposit *the grounds for deposit* shall exist and the thing subject to transfer shall be suitable for deposit. The grounds for deposits are:

- a) delay in acceptance of the performance by the creditor;
- b) non-existence of information about the creditor’s address.

In case of release from obligation by deposit any kind of object cannot be transferred; the latter shall be *suitable for deposit*. First of all, according to the law money and securities are suitable for deposit but this list is not complete. For instance, suitable are also valuables, precious stones, etc. Perishable objects shall not be accepted for deposit. All expenses with respect to the storage shall be borne by the creditor.

The court or the notary public shall notify the creditor of the acceptance of the object for deposit and shall demand from him the acceptance of the object. The court or the notary public *shall keep it for a period of up to three years*. If within this time the creditor fails to accept the object the debtor shall be notified and demanded to take back the object. If within the period of time set for return of the object the debtor fails to take the object the latter shall be deemed to become the state property. (Civil Code of Georgia, Article 441, 2002)

Set-off

1. Notion and legal nature of set-off

In case of *set-off* two persons, on various grounds, have other reciprocal claims against each as well as obligations. However, only the state of holding the reciprocal claims is not sufficient for set-off that claims; notification about the set-off by one party to the other party is also required. Consequently, set-off of the claims is exercised with a unilateral declaration of intention – unilateral transaction made by any party which shall be delivered to the other party. This (unilaterally expressed) set-off must be differed from the mutual agreement on set-off of the claims, which is not regulated by the civil legislation but it is possible and permitted according to the principle of freedom of contracts. As a result of set-off the claims are cancelled (and the obligations are terminated); the maker of set-off loses his claim. (Brox, 2007, pp.135-138)

2. Pre-conditions of set-off

Pre-conditions of set-off are:

- a) reciprocity of the claims

The claims must exist between the same persons: each participant is the creditor and debtor at the same time. Usually, the claim belonging to the set-off maker’s opposition party is called the main claim in the legal literature (*passive claim*) and the claim of the party by which set-off is carried out, – *the counter-claim (active claim)* (Brox, 2007, pp.135-138).

- b) reciprocity of claims

The claims subject to set-off must be *reciprocal*; for instance, set-off of the pecuniary claims shall be carried out also against the pecuniary claims. In addition, it is notable that only non-specific things are suitable for set-off; (Brox, 2007, pp.135-138)

- c) existence of the claims – maturity of the claim

The claims subject to set-off must be *mature*. Such requirement of law is obvious since a person should not be enti-

tled to use the claim for his benefit if this claim has not arisen yet. There is an exception from this general rule. In particular, set-off of the claims is permissible even when one of the claims is not mature but its holder consents to the set-off (Civil Code of Georgia, 2002, Article 442). Set-off is also permissible when the claims subject to set-off do not fully compensate each other. In this case a claim shall be paid off, the value of which is less than of the other claim.

If a contracting party who has been notified of a set-off has **several claims** subject to set-off, then the provisions of Article 387 shall apply:

“If the debtor is obligated before the creditor for several similar performances arising out of various obligations, and what has been performed is not enough to pay all the debts then the obligation chosen by the debtor for satisfaction at the time of performance shall be paid off; and if the debtor does not choose then that debt shall be paid off which was the first to become due.

If the claims become mature simultaneously, then the claim which is the most burdensome for the debtor shall be performed first.

If the claims are equally burdensome then the claim for which the least security exists shall be performed first”.

3. Legal consequences of set-off

In accordance with the opinion admitted in the legal science in case of set-off the claim is cancelled ; as far as the claims are to be covered, they shall be deemed cancelled at the moment when they are put against each other. Therefore, the moment of set-off is related not to the moment of notification but just – state of set-off.

In certain cases the law **does not permit set-off**. In particular, set-off is not permissible:

- a) if set-off of claims was excluded beforehand by agreement;
- b) if against the object of the obligation cannot be foreclosed or if it is the claim for an alimony;
- c) if the obligation is related to the compensation for damages that have been caused by infliction of harm on a person’s health or death;
- d) in other cases determined by law (Civil Code of Georgia, 2002, Article 447). For instance, according to the second sentence of the Article 205, in case of delegation of debt the new debtor is not permitted to offset the claims belonged to the old debtor.

Remission of Debt

1. Notion and legal nature of remission of debt

Remission of debt is not a unilateral act (unilateral transaction) from the holder of the claim – creditor. The remission of debt is an agreement between the parties – a contract, according to which the creditor releases the debtor from the obligation. For that reason, the latter’s appropriate declaration of intention – an acceptance is required. However, the debtor’s silence may often be considered as acceptance to the creditor’s offer to make a remission of debt. (Brox, 2007, p.143)

Remission of debt is a by its legal nature; the creditor’s right is cancelled as a result of it. It is an abstract agreement and therefore independent from the causal transaction used as its basis (which, as a rule, is donation). If the latter is void, it does not affect the validity of the remission of debt as a disposition transaction; in this case the creditor shall have the claim in

accordance with the provisions of the unjust enrichment. Certainly, the parties can make the validity of the remission of debt conditional on the validity of causal transaction.

2. Distinction between the remission of debt and the agreement to terminate the obligatory relationship.

We should differentiate, on the one hand, the agreement of the remission of debt and, on the other hand, the **agreement to terminate the obligatory relationship**. In first case (one) claim (the claim which is forgiven by the creditor) is cancelled. In second case (whole) obligatory relationship is terminated.

3. Legal consequences of remission of debt in cases of the joint and several obligations and the obligations secured by suretyship.

Remission of debt for one of **the joint and several debtor** releases from the obligation the other joint and several debtors as well, except when the creditor retains his claim against them. In such case the creditor may only assert the claim against the rest of the joint and several debtors reduced with the share of the released debtor. (Civil Code of Georgia, 2002, Article 449)

Remission of debt granted to the principal debtor releases **the sureties** as well. Remission of debt granted to the surety does not release the principal debtor from performance of the obligation. Remission of debt granted to one surety releases the other sureties as well. (Civil Code of Georgia, 2002, Article 450).

Confusion

Confusion – coincidence of the features of the creditor and debtor – must be distinguished from the set-off. If in case of set-off two claims are to be cancelled, in case of confusion – only one obligation shall be terminated. However, in case of confusion the claim is not extinguished as far as the rights of other persons are concerned when, for instance, a claim is encumbered with the pledge of a third party. (Brox, 2007, p.145)

Death of Debtor or Creditor and Winding-up of a Legal Person

Death of an individual (either debtor or creditor) does not always lead to termination of the obligation. On the assumption of the contrary, the interests of the creditor could be absolutely insecure. For instance, pecuniary obligations are not terminated in case of death of debtor; they will pass by succession to the heirs. Death of debtor will lead to termination of the obligation only when the performance is impossible without the debtor’s personal participation. Death of the creditor will lead to termination of the obligation if the performance was intended personally to him.

Contrary to the cases of the individuals, winding-up of a **legal person** (either debtor or creditor) always leads to termination of the obligation.

Other Grounds for Termination of the Contract and Obligation in General

1. Impossibility of performance of the obligation

The obligation is terminated when its performance is **objectively and finally impossible** (impossibility of performance of the obligation). For instance, the specific thing has been destroyed without the possibility of its restoration. If the perfor-

mance of the obligation is impossible in part the debtor shall not be released from the whole obligation but only in its impossible part.

2. Reaching the goal

Although in case of *reaching the goal* the debtor's act with regard to the performance of the obligation is possible but the point is that it is no more needed since it has already been reached without the participation of the debtor. For instance, before the medical examination and treatment of a patient by the doctor, the former has been recovered as a result of self-treatment. Reaching the goal differs from the impossibility of performance with the following: in case of reaching the goal the debtor is ready for performance and he is able to do it; however, performance by the debtor is pointless since the goal set by the agreement has already been reached otherwise. Contrary to the impossibility of performance, in case of reaching the goal the creditor's interests are satisfied. (Brox, 2007, p.146)

3. Frustration

In case of *frustration* the debtor was able to carry out the act with regard to the performance of the obligation but the object, as to which there does not exist the promised performance which was to be carried out (Brox, 2007, p.147) (for instance, before starting the medical treatment by the doctor the patient dies).

Conclusion

Above we have briefly reviewed main legal issues regarding the grounds for termination of the obligation under the Georgian law: performance of the obligation, novation, deposit, set-off, remission of debt, confusion, death of debtor or creditor and winding-up of a legal person, impossibility, frustration. I.e., we pointed out the performance must be proper in order to result in the termination of the obligation. In addition, the obligatory relationship is terminated by novation when the participants of the relationship agree to terminate the already existing obligation by creating the new one on its place. However, there is no provision regulating the novation in the Civil Code of Georgia. The debtor is also entitled to place the object of performance on deposit with a notary public or court, and deposit the money or securities to the deposit account of a notary public when the creditor delays acceptance of the performance or his address is not known. Set-off may be carried out when two persons have against each other reciprocal claims as well as obligations. Set-off is exercised with a unilateral declaration of intention made by any party. Unlike the set-off, remission of debt is not a unilateral act (unilateral transaction) from holder of the claim – creditor; it is an agreement between the parties – a contract, according to which the creditor releases the debtor from the obligation. Finally, confusion – coincidence of the features of the creditor and debtor – must be distinguished from the set-off. If in case of set-off 2 claims are to be cancelled, in case of confusion – only one obligation shall be terminated.

References:

Brox, W. (2007). Allgemeines Schuldrecht [General Obligation Law]. (A. 32., Ed.)

Civil Code of Georgia. (2002). Article 428, Article 441.

German Civil Code. Annahme an Erfüllungs statt. [Acceptance in lieu of performance] Paragraph 364 .

Additional Literature:

Australian Legal Information Institute, retrieved on June, 2012 from <http://www.austlii.edu.au/>

Austrian Institute of Technology, retrieved on July, 2012, from <http://www.arcs.ac.at/DissDB>

Colorado General Assembly, retrieved on August, 2012, from www.leg.state.co.us

German Civil Code – BGB, Translation provided by the Langenscheidt Translation Service, 2009, juris GmbH, Saarbrücken Edition

German Law Archive, retrieved on June, 2012, from <http://www.iuscomp.org/gla/>

Literaturquellen zum deutschen, österreichischen und schweizerischen Privat- und Zivilprozeßrecht des 19. Jahrhunderts, [Literature sources for German, Austrian and Swiss Private and Civil Procedural Law] retrieved on 2012, from DIGITALE BIBLIOTHEK [Digital Library], <http://dlib-mpier.mpg.de/>

Palandt, Bürgerliches Gesetzbuch [German Civil Code], bearbeitet von Bassenge, Diederichsen, Edenhofer, Heinrichs,

The Civil Code of Georgia, 2001, IRIS Georgia

The Italian Civil Code, 1969, Oceana Publications, Inc.

University of Hull, retrieved on September, 2012, from <http://www.hull.ac.uk>