Are commercial banks more "reliable" than insurance companies?

Exclusionary conduct of Georgian public procurers to the prejudice of insurance companies

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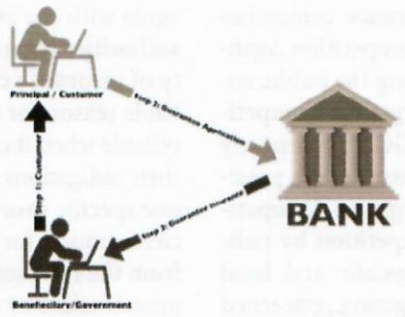
Public procurement is acknowledged to be one of the most significant functions of public entities. The rational spending of state resources, the establishment of a proper competitive environment for undertakings and the development of a free market economy are the major rationales behind public procurement legislation. Public procurement procedures are intended to ensure the fair allocation of public resources among undertakings, which is an important way to achieve fierce competition on different markets.

The contract arising between a public entity and a supplier/service provider as a result of a public tender provides the legal basis for the imposition of mutual demands and obligations. According to the terms of a procurement contract, the concerned public enity has the right to demand that the supplier/service provider fulfills the obligations contained within the contract and the supplier/service provider has the right to receive appropriate remuneration in return. However, there is always a risk that the supplier/service provider subject to such a contract will breach the terms contained therein, thereby posing a threat to the protection of the public interests attached to the proper fulfilment of the contract.Therefore, the mitigation of this risk is of great significance and forms the basis behind the mandatory tender condition envisaged by the Georgian public procurement legislation, which obliges the supplier/service provider to provide the contracting public authority with an appropriate bank guarantee.



The Georgian public procurement legislative framework recognises 2 types of bank guarantees. The first type of bank guarantee ensures the adequate fulfillment of the public procurement contract from the side of the concerned supplier/service provider ("contract performance guarantee"), while the second type of guarantee refers to the protection of the state funds that were given to the concerned company prior to the performance of the obligation contained in the public procurement contract ("advance payment guarantee").

It is worth mentioning that the Georgian Civil Code (hereinafter "GCC") does not make any distinction between the two different types of issued guarantees, with both being referred to as "bank guarantee". In particular, pursuant to Art. 879 GCC "By virtue of a bank guarantee, a bank or any other credit institution or insurance organisation (guarantor) undertakes in writing, at the request of another person (the principal), to pay a sum of money to the principal's creditor (the beneficiary), according to an assumed obligation, at the principal's written request".

In this regard, it should be noted that the GCC recognises *commercial banks, insurance companies and any other credit institutions* as organisations that are equally entitled to issue bank guarantees and provide markets with this service. Hence, a supplier/service provider that is obliged to provide a public entity with a bank guarantee has three ways of obtaining the necessary bank guarantee. Namely, the supplier/service provider can acquire the necessary bank guarantee either from a commercial bank, insurance company or other credit institution. Thus, the mentioned institutions are potential contracting parties for suppliers/service providers. This approach of the Georgian legislator, which is laid down in Art. 879 GCC, creates a legal and equal expectations for all of these institutions to be able to compete in the relevant market by offering bank guarantees to bidders. In addition, Art. 13 of the Law of Georgia on Public Procurement declares that "A contracting authority shall define qualification criteria for each particular procure-

ment that the tenderers are to meet in order to participate in the procurement", while also stipulating that "Requirements in qualification criteria shall be fair and non-discriminatory and promote effective competition".

However, recent developments in the area of public procurement revealed that certain public entities were exhibiting a strong preference for the Georgian Banking Sector over the Insurance Sector. Such preference could be seen, for example, in the conditions of the invitations to tender issued by Georgian public procurers, according to which the required bank guarantees could only be issued by commercial banks. This requirement concerned both contract performance guarantees and advance payment guarantees. The inclusion of this requirement in the invitations to tender of public authorities obliged suppliers/service providers to obtain bank guarantees only from commercial banks, thereby excluding insurance companies and other credit institutions from the relevant market. As a consequence, a significant number of bidders already holding bank guarantees issued by insurance companies were obliged to obtain new guarantees from commercial banks. This type of exclusionary conduct became very common among public entities and threatened to prevent the whole insurance sector from operating on the relevant market, in violation of the right provided by the Georgian civil legislation. This threat resulted in an increasing number of consumers switching from insurance companies to commercial banks.

Due to these circumstances, there was a pressing need to change this practice, with a view to restoring equal competitive conditions between commercial banks and insurance companies. In particular, the affected insurance companies submitted two different complaints to the Competition Agency of Georgia (Hereinafter – "GCA") regarding the public entities' breach of Art. 10 of the Law of Georgia on Competition. On the basis of these complaints the GCA successively launched two separate investigations concerning the possible breach of Article 10 of the Law of Georgia on Competition, which prohibits the distortion of competition by public entities, authorities of Autonomous Republic and local self-government authorities. The first investigation concerned contract performance guarantees and the second related to advance payment guarantees.

The reasoning and argumentations presented by the public entities involved were almost identical in both cases. Respondents indicated the following grounds and arguments in order to justify their exclusionary practices:

1. commercial banks issued bank guarantees with more caution as they studied the company's history in a more detailed way;
2. banks were more solvent;
3. in case of necessity, banks reimbursed the guaranteed amount more rapidly and easily compared to insurance companies and
4. they had "bad" experience with several insurance companies in terms of the reimbursement of guarantees.

Based on an overall analysis of the cases the GCA concluded that the above-mentioned arguments did not provide sufficient justification for the restriction. When coming to this conclusion, the GCA took into account that according to the annual report of the Georgian National Bank, 16 commercial banks, 16 insurance companies and 75 credit organisations were operating in Georgia. Consequently, the disputed practice had significantly reduced the number of undertakings operating on the relevant market, which was acknowledged by the Competition Agency as posing a great threat to the competitive environment on the bank guarantee market. This alarming data was of vital importance from a competition law standpoint and highlighted the need for competition enforcement to be strengthened in this field.

The insurance market in Georgia is strictly regulated and supervised by the LEPL Insurance State Supervision Service of Georgia. The financial sustainability of insurers is thoroughly observed and scrutinised by the supervisor. During its investigations the GCA analysed all of the relevant information and came to the conclusion that the applicable legal obligations and very strict regulatory rules guaranteed the financial stability of insurance companies, as regards to the complete reimbursement of the bank guarantees issued by them. Furthermore, it was found that special insurance legislation included rational and proportional risk mitigation mechanisms in order to avoid the breach of obligation deriving from the financial institute in question. Therefore, the GCA did not agree with the arguments put forward by the concerned state authorities regarding the financial instability and incredibility of insurance companies. Consequently, there was no justifiable reason for claiming that insurance companies were less reliable when it came to meeting their liabilities and fulfilling their obligations on time. Furthermore, the past ill practice of one specific insurance company was deemed to be an insufficient ground for the exclusion of the whole insurance sector from the relevant market. Hence, the GCA stated that the approach taken by the concerned public entities had unreasonably and disproportionally restricted competition and could not be justified on the grounds indicated by the respondent bodies.

Due to these circumstances, in both cases the GCA established the infringement of Article 10 of the Law of Georgia on Competition. Here it is worth mentioning that the that Georgian Competition Law does not actually provide for the imposition of a fine in the event of a breach of one of the provisions contained in the Law of Georgia on Competition by a public entity. Consequently, in order to restore a competitive environment on the relevant market, the GCA made use of the only tool at its disposal, namely the elaboration of a recommendation. In particular, the GCA recommended that the

public authorities should bring to an end the above described unlawful practice suitable to exclude insurance companies from the relevant market. Given that the recommendations of the Georgian Competition Authority must be followed by all other public entities, the fulfillment of the issued recommendations is under the permanent monitoring of the GCA.

It must also to be noted that the respondent public entities appealed against the above-mentioned decisions of the GCA at the Tbilisi City Court. The first court case concerning contract performance guarantees was decided in favour of the GCA, while the second appeal concerning advance payment guarantees is still ongoing before the court.

The GCA is currently conducting an impact assessment in order to evaluate the overall positive impact of the aforementioned decisions on the relevant market.