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Outsourcing

Georgia

Nodia, Urumashvili and Partners Ltd

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Law and Practice

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Nodia, Urumashvili and Partners Ltd (Tbilisi - HQ) was founded in 2005 and since then provides the highest quality legal and tax advice to its clients. The firm's success is the result of its skilful and detail-oriented lawyers. The firm has pre-eminent banking, financial and tax law practice and assists its clients during negotiations, execution of real-estate, energy and infrastructure projects with particular strength in FIDIC forms and construction disputes, provides best

advice to corporate, commercial and M&A, helps to avoid disputes, and provides representation in all forms of dispute resolution. Furthermore, it is noteworthy that the firm has a unique understanding of a cryptocurrency and blockchain-based technologies. The key areas of the practice of the firm include tax, banking and finance corporate and M&A, commercial restructuring and insolvency, construction, real estate, energy, and dispute resolution.

Authors



Eprem Urumashvili has been a partner at the firm since 2010. He has more than 19 years of work experience in domestic taxation and is regarded as a leading individual in the field of tax law by various ranking organisations. He is also a

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1. Outsourcing Market

1.1 IT Outsourcing

Recent researches show that the global IT outsourcing (ITO) and business process outsourcing (BPO) markets have changed substantially in the last few years. The new technologies had a significant impact on the global market and are driving growth within the outsourcing space. Despite the fact that the Georgian BPO and ITO markets are relatively young, new technologies are having a substantial impact. Two main outsourcing trends may be discerned: first, Georgia as an attractive offshore outsourcing pool for other countries without specific regional focus and ITO and BPO companies serving both English and Russian speaking countries; and, second, a Georgian internal outsourcing market for domestic companies seeking to transfer operational tasks to private entities in order to support the business.

Georgia has one of the most favourable business climates in the region. Georgia's competitive advantages, such as flexible tax and labour legislation, low tax rates, easy company set-

up, both fresh and experienced talent, visa-free agreements with over 100 countries, and low energy costs, make Georgia an attractive destination for BPO and ITO industries and multinational companies. There is an increasing number of Georgian companies providing different outsourcing services to local and international companies. The Georgian National Investment Agency is actively promoting Georgia as an attractive outsourcing country. International technology giants, such as Bitfury Group, one of the world's largest blockchain technology companies, are actively operating in the Georgian market.

1.2 BP Outsourcing

See 1.1 Outsourcing

1.3 New Technology

One of the best examples of how the new technologies have impacted the Georgian outsourcing market is the case of blockchain. In recent years blockchain has become one of the most flourishing trends in the world. Blockchain has attracted the attention of many industries, including the fi-

nancial sector, healthcare, legal services, the public sector, etc. Blockchain technology has significantly impacted the IT outsourcing sector and some of the large industry players are now trying to offer blockchain-based IT solutions to different companies. In recent years, we have been witnessing how blockchain technologies have become more widespread in the Georgian market, with Georgian government being the main supporter and customer.

Blockchain has had a significant influence on the public sector. Bitfury is rendering its services to the Georgian government. Nodia, Urumashvili and Partners' team, led by one of the partners, Mr Eprem Urumashvili, provides tax and legal advice to Bitfury in Georgia. The first service offered to the Georgian government was the Georgia land titling pilot project. Bitfury's vice chairman, Mr George Kikvadze, explains that there were three main reasons for targeting Georgia: existing infrastructure of two data centres, good digitalised system of registering property, and a developed Free Industrial Zone (FIZ). Currently, it is possible to register Georgian land titles directly on the blockchain. Georgia has therefore become one of the first countries to use the blockchain platform to complete property-related government transactions. Bitfury envisions that smart purchase and sale contracts via the blockchain will come next, and from there, a full suite of property-related services. Eventually, as Bitfury believes, blockchain may lead to transformation in government services.

The success of blockchain technologies in Georgian government services has been studied in a Harvard Business School case study. The detailed case study prepared by Professor Mitchell Weiss and Assistant Director Elena Corsi of the Europe Research Centre can serve as a trigger for further studies of outsourcing market trends.

The Georgian internal outsourcing market is also rapidly developing. More and more companies are choosing to use outsourcing services rather than using internal resources for routine activities and business support. The Georgian BPO industry offers a wide variety of services, but the most frequently outsourced services include inbound and outbound call centres, data mining and research, IT support, telemarketing, HR outsourcing, translation, back office administrative support and accounting services.

Companies providing outsourcing services are focusing on the customer experience by empowering users through ready and easy access to information and services. Several insurance companies and banks have developed bots that shift focus to the needs of end users.

1.4 Other Key Market Trends

In summary, Georgia may become a major destination for outsourcing in the region, if it continues to evolve with the changing needs of the global outsourcing market. As the

needs of the local outsourcing market mostly follow the global market needs, outsourcing would become more attractive to companies operating in the Georgian market as well.

2. Regulatory and Legal Environment

2.1 Legal and Regulatory Restrictions on Outsourcing

Georgian law does not recognise outsourcing law as a separate discipline. No legal definition of "outsourcing" is found.

There are no general legal or regulatory restrictions on outsourcing in Georgia. Outsourcing transactions are mainly governed by civil laws, for example, the Civil Code of Georgia, with due consideration of other specific laws, such as tax, data protection, employment law and others, depending on the nature of the transaction and industry. In the Civil Code of Georgia, relevant provisions may be found in the general provisions concerning contracts (such as contract formalities, validity, interpretation – see Articles 327-360), as well as in the contract-specific provisions for works and services (see Articles 629-656) and assignment (see Articles 709-723).

2.2 Industry-Specific Restrictions

Industry-specific restrictions or compliance issues are mostly applicable in respect to the regulated services, such as financial services. Activities that are characterised by excessive hazard to human life or health, that involve state or public interests of special importance, or that are related to the use of state resources may be subject to licences and permits.

Outsourcing in the public sector is also subject to legal restrictions due to the necessity to follow a specific legal framework of public procurement. Specific procurement procedures are applicable to the outsourcing of certain activities to a private company (for example, law firm, audit firm, etc.).

Obtaining state permits and licences for certain services and activities may be considered as the most common regulatory requirement. Regulated activities, types of licences and permits, issuance terms and other relevant provisions can be found in the Law on Licences and Permits of Georgia. Such licences include, for example, insurance licence, banking activity licence, securities brokerage licence, private security licence.

2.3 Legal or Regulatory Restrictions on Data Processing or Data Security

Under the Law of Personal Data Protection of Georgia, data processing is any operation performed in relation to data by automated, semi-automatic or non-automatic means, in particular collection, recording, photographing, audio recording, video recording, organisation, storage, alteration,

restoration, request for access to, use or disclosure by way of data transmission, dissemination or otherwise making the data available, grouping or combination, locking, deletion or destruction. Data processing is allowed if there is the consent of the data subject. Consent should be expressed in either written or other appropriate means that enable the will of the data subject to be clearly established. Data may be processed only for specific, clearly defined and legitimate purposes.

Cross-border data flows are permissible if there are grounds for data processing under the Law of Personal Data Protection and if appropriate data protection guarantees are provided by the respective state or international organisation. Data may be also transferred to other states and international organisations, if the data transfer is part of a treaty or an international agreement of Georgia; or a data processor provides appropriate guarantees for protection of data and of fundamental rights of a data subject on the basis of an agreement between a data processor and the respective state, a natural or legal person of this state or an international organisation. In the latter case, the permission of the state Personal Data Protection Inspector is required.

2.4 Penalties for Breach of Such Laws

Administrative as well as criminal liability is prescribed for the breach of data protection regulations. Administrative penalties are prescribed for specific breaches and their amount varies from GEL500 (for example, data processing without lawful grounds, violation of principles of data processing) to GEL10,000 (using data for direct marketing purposes in violation of the rules under the law committed by a person who had an administrative penalty imposed in the course of one year for the same activity).

The most severe criminal liability, of imprisonment from four to seven years, with or without deprivation of the right to hold an office or to carry out activities for up to three years, is prescribed for (a) unlawful obtaining, storage, use, dissemination of or otherwise making available information on personal data, or (b) unlawful use and/or dissemination of information contained in personal data through a piece of work disseminated in a certain way, through the internet, including social networks, mass media or other public appearance, committed by a person who, due to his/her official position, professional activities or other circumstances, was obliged to keep this information or data confidential, or who committed the above act using his/her official position.

2.5 Contractual Protections on Data and Security

For compliance purposes, the following contractual provisions on data and security are usually included in contracts: scope and aim of data processing, description of technical and other measures to be taken for data protection purposes, information on 'cookie' use, liability, data storing term.

3. Contract Models

3.1 Standard Supplier Customer Model

Georgian legislation does not contain specific regulation for outsourcing contracts. Instead, it is governed by general provisions of the Civil Code of Georgia applicable to service contracts. The relevant chapter of the Civil Code of Georgia regulating service contracts consists of default rules which may be applicable if parties have not agreed on other terms in the contract. These default rules have been created to govern essential terms of service relationships, such as the scope and specification of services, payment terms, liability, etc. Therefore, the default terms of the service contract provided in the Civil Code can be altered, excluded or extended by the parties to the agreement, to the extent permitted by the law.

There are no specific rules in the Civil Code of Georgia governing business process outsourcing contracts. However, depending on the industry, in certain cases the outsourced services may be subject to mandatory rules contained in various pieces of legislation. For instance, provision of certain professional services, such as attorney and audit services, are governed by specific mandatory rules (for example, the anti-money laundering legislation imposes specific obligations on attorneys and audit firms to monitor certain transactions of their clients).

Therefore, there are no standard outsourcing contract models established by the legislation. There are a set of default rules in the Civil Code governing service contracts, and parties are free to adjust these general terms to their relationship model and create a tailor-made outsourcing contract considering their needs in each specific case. There are many options available per individual case depending on the industry. As a rule, the most common model of outsourcing contract would include a description of essential conditions, such as the price, payment arrangements, scope of services, performance quality and standards, liability, termination clause, the remedies available for each party and other essential conditions considering industry best practices. Apart from general clauses governing service contracts, there are certain essential terms typical to all types of outsourcing contracts, such as the data protection rules, liability, confidentiality, IP, general legal compliance as well as the compliance with the customer's internal policies and the service-specific industry rules.

However, there are specific pieces of legislation applying to various regulated industries, that among others, govern the terms and conditions of the outsourcing contract. For instance, public procurement is one of the highly regulated fields and contract terms are often substantially different from the established practices in the private sector, mainly due to the mandatory nature of the laws applying to public procurement contracts.

Public contracting is regulated by the law on public procurement and the number of bylaws adopted by the State Procurement Agency. These rules are mainly concentrated on issues relating to the planning and the procedure (specifically merit-based selection of service providers) for contracting by state agencies; however, they significantly affect the content and the terms of the contract as well. For instance, state bodies are required by the law to obtain security from the provider if the value of the contract exceeds GEL200,000. Security measures may be selected by the procuring body itself, depending on the type of product or services acquired, but as a rule a bank guarantee is the most commonly used type of security. In exceptional cases the procuring agency is entitled to discharge the contracting party from the obligation to submit the security considering the business reputation of the service provider and the quality of the goods and services provided.

Amendments to public procurement contracts are strictly governed. State bodies are limited to amending the contract which provides for the increase of prices. Advance payments made by state bodies are also prohibited by the law, unless the service provider provides a bank guarantee or under other limited circumstances.

Apart from the above-mentioned, the law and decrees of the State Procurement Agency contain the detailed regulation of certain essential terms of the contract which vary per product and service, but in general include the following: price-fixing mechanisms for certain products, delivery terms of the service or product, language of the contract, payment mechanism, deadline for the provision of services and duration of the contract.

Considering the above-described mandatory rules of the law, the standard terms and conditions of outsourcing contracts in public procurement sphere are highly standardised.

Apart from public contracting, there are other areas subject to specific mandatory rules, such as banking and finance, insurance, employment, personal data protection, telecommunication, public health and medical services, pharmaceuticals, construction, hospitality, etc. In addition to standard default rules of the Civil Code of Georgia and industry-specific best practices, outsourcing contracts in the above-mentioned industries are governed by mandatory rules specific to each industry.

3.2 Alternative Contract Models

Alternative contract models for outsourcing can vary per sector. They are mainly influenced by requirements of the procuring company or state body. In the public contracting sector, applicant companies are often encouraged to participate in the call through joint ventures in order to meet all the requirements set forth by the procuring body. Multisourcing is a frequently used tool by private companies and state

bodies especially if single applicant companies are not able to cover the whole scope of services or products sought by procuring entities. For instance, while outsourcing the legal services, state bodies will, case by case, require a local service provider to establish a partnership with foreign providers to ensure provision of expertise in both local and foreign jurisdictions.

3.3 Captives and Shared Services Centres

The use of captive services and shared service centres is most commonly an established practice in large groups of companies and holdings. Commercial banks and other financial service actors represent the largest corporate groups in Georgia. However, corporate groups exist in other industries as well, including real estate, oil and gas, FMCG, hospitality, telecommunication, etc. In certain cases, captive units and shared service centres are used to provide distribution services to group member companies, sale and marketing services, debt collection and claim enforcement services.

4. Contract Terms

4.1 Customer Protections

In case of breach of the outsourcing contract, customers may apply a variety of legal remedies provided by the law or by the contract. Certain protection mechanisms are provided by the Civil Code provisions governing service contracts. As a rule, the customer is entitled to terminate the contract at any time, without good reason, provided that the customer pays for the works performed and damages caused by termination. On the other hand, the service provider is entitled to terminate the contract based only on a valid reason. The service provider is obliged to render services in agreed quality and quantity. If the provider fails to comply with the agreed quality or quantity of services, the customer is entitled to request additional performance at the cost of the provider to remedy the non-conformity. As an alternative, the customer is entitled to correct the defect at its own cost and request compensation of expenses from the provider or request the provider to decrease the service fee proportionally. The customer has an ultimate statutory right to terminate the contract and request compensation for damages resulting out of non-performance or undue performance of obligations by the service provider, provided that the customer issues a warning or prescribes additional reasonable time for the correction of non-performance (cure period) and the service provider fails to remedy the drawbacks of the services.

In addition to statutory remedies and protection mechanisms provided by the Civil Code, the parties typically include a variety of other instruments in their contracts. Such mechanisms may include the customer's right to demand the removal of unsatisfactory staff or subcontractors and their replacement with suitable ones, financial penalty imposed on the service provider per day of delay of an agreed

deadline (which would typically vary up to 1% of the total service fee per day), withholding of a disputed charge, etc. One of the most frequently applied protection mechanisms for the customer is the submission of a bank guarantee, performance bond or other type of financial guarantee by the service provider. Outsourcing contracts may also contain the number of mechanisms related to the assurance of the quality and efficiency of the services, such as mandatory requirements for training and experience of staff. Parties to the contract may also agree on indemnities related to potential third party claims, such as IP rights violation, damage to property, labour claims, physical injury of personnel, tax-related issues, breach of confidentiality and other material issues, even though the concept of indemnity is not embodied in the law. In all cases, the service provider may be held liable only for the breaches arising out of its fault. In certain industries, parties agree on the maximum monetary limits of the service provider's liability in case of non-performance. However, these financial limits do not apply to intentional wrongdoings by the service provider. All of the warranties and indemnities described above are created by the parties through the contract and, therefore, they are negotiable.

4.2 Termination

Apart from the statutory termination rules described above, parties are free to include any other, more specific clauses governing the right of each party to terminate the contract with or without valid reason and before or after the expiration of the contract term. Generally, but within certain limits, the case law is supportive to the freedom of the parties to agree on termination rules specifically adjusted to their relationships and such rules are successfully enforced through litigation.

4.3 Liability

Georgian civil legislation differentiates between actual damages and loss of income. Actual damages cover additional expenses incurred as a result of the non-performance and which directly derive from actions of the party. The concept of actual damage serves to restore initial conditions and to put the non-breaching party in the position it would hold if the other party had performed the obligations as agreed in the contract.

On the other hand, loss of income refers to the revenues which would have been available for the contracting party had the other party duly performed its obligations.

In both cases, the injured party must prove the causal link between the action of the defaulting party and the damages incurred. However, the standard of proof is relatively higher in case of loss of income. Loss of income cannot be claimed for all revenues; rather, it shall apply to the revenues which would become available for the injured party in the course of the usual business practice and which would have been reasonably predictable for the breaching party.

4.4 Implied terms

Apart from general terms of the service contract and the industry best practices, there are some overriding principles of the Civil Code which are implied in all contracts, including outsourcing contracts. The principle of good faith and fair dealing is a cornerstone of all legal relationships between private parties and is implied in outsourcing contracts. Liability for intentional wrongdoing is also deeply rooted in the civil legislation as a core value. The parties do not enjoy the freedom to exclude the liability for intentional breach.

There are some implied terms specifically relevant to service contracts. The compensatory nature of the service provision is a standard term implied in service contracts. If the parties have not agreed on the amount of compensation for services, the standard market rates may be applicable to determine the amount of service fee. Yet another implied term relates to the quality of the services. If parties have not expressly agreed on the quality of services, then the service provider is expected to produce the quality for ordinary use.

5. HR

5.1 Rules Governing Employee Transfers

Generally, employment relations are regulated under the Labour Code of Georgia. No specific rules governing employee transfers for outsourcing may be found in Georgian law.

5.2 Trade Union or Workers Council Consultation

No explicit procedure for trade union or works council consultation for outsourcing is prescribed under Georgian law.

5.3 Market Practice on Employee Transfers

Change by an employer of an employee's place of performing work, which may be caused by transfer for outsourcing or otherwise, if it takes the employee more than three hours a day from their place of residence to the new place of work and back by publicly accessible transport, and if it results in disproportionate costs for the employee, is considered to be change of the essential conditions of the employment agreement and thus requires the mutual agreement of the parties.

Transfer for outsourcing may be also deemed a business trip that is defined as a temporary change by an employer of an employee's place of work in the interest of the work. Sending an employee on a business trip by an employer shall not be deemed a change of essential conditions of a labour agreement unless the period of a business trip exceeds 45 calendar days annually.

6. Asset Transfer

6.1 Asset Transfer Terms

No specific terms apply to asset transfer in outsourcing agreements under Georgian law. Transfer may be conducted under various contractual arrangements depending on the type of service. An agreement is considered to be entered into if the parties have agreed on all of its essential terms in the form provided for such agreement. Rules on sale, lease and licensing may be applicable.

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