



# STATE PROPERTY MANAGEMENT FRAMEWORK ASSESSMENT

FINAL

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# **STATE PROPERTY MANAGEMENT FRAMEWORK ASSESSMENT**

FINAL

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# DATA

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# ABSTRACT

The management, privatization, and disposal of state property in Georgia is primarily governed by the Law on State Property of 2010 (LSP) and the various pieces of secondary legislation issued under that Law. The LSP did not radically change the framework for management, privatization, and disposal of state property which existed before 2010, and although the LSP has undergone several revisions since it was passed (a new set of amendments is currently being proposed by the Ministry of Economy and Sustainable Development (MoESD)), these relate mainly to the processes by which the Law's objectives are to be attained and not the underlying principles and methods of management, disposal, and privatization of state property.

This report is an assessment of the Government of Georgia's (GoG's) privatization process, including the regulatory environment, with recommendations for improvements in that process to bring it into line with international best practice. We are therefore proposing high-level recommendations for improvement of the legal and regulatory framework, as well as more specific proposals for the subsidiary (but critically important) process by which the GoG's privatization goals can be achieved in accordance with international norms in this field. Our review of the framework and the process has identified some considerable gaps between Georgian law and practice, both pre-2010 and since the LSP was passed, and that which is applied in most other countries which have undergone large-scale state property privatization programs. It is recognized that good progress has been made and a substantial amount of state property has already been sold or disposed of in the 20 years since Georgia's independence and our focus therefore is primarily on the two key types of state property where there is still much to be done and where many issues remain unresolved—**state owned land** and **state enterprises**.

# ABBREVIATIONS

APLR	Association for the Protection of Landowners Rights
CoC	Chamber of Control
EBRD	European Bank for Reconstruction and Development
EMA	Enterprise Management Agency
GEL	Georgian Lari
GDP	Gross Domestic Product
GoG	Government of Georgia
GPS	Global Positioning System
GYLA	Georgia Young Lawyers Association
HPP	Hydro Power Project
IPO	Initial Public Offering
LEPL	Legal Entity of Public Law
LGSU	Local Self-Governing Unit, municipal or district authority
LMDP	Land Management Development Project
LSP	Law on State Property
MoF	Ministry of Finance
MoESD	Ministry of Economy and Sustainable Development
NAPR	National Agency of Public Registry
PoG	President of Georgia

RoM	Rights of management
SPMIS	State Property Management Information System
DoSPMP	Department of State Property Management Policy
USD	United States Dollars

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# I. EXECUTIVE SUMMARY

In compiling this report, we have:

- Interviewed officials at the MoESD, including two deputy ministers
- Talked to representatives of the private sector with an interest in privatization and to colleagues at EPI with expertise in key areas
- Met with organizations independent of government with objective views on the privatization process
- Reviewed all relevant current laws and secondary legislation relating to privatization of state property
- Reviewed the World Learning/FORECAST E-Government Report Stage II
- Researched available written and online data and information on privatization and economic matters, generally in Georgia

Obtaining consistent and accurate information on privatization in Georgia is problematic, in particular up-to-date translations of the laws are not available. This is partly because of what has been termed the ‘chaotic’ and rapidly changing nature of the process of state property management and privatization and also the lack of reliable electronic sources of information. Privatization has, up until recently, been a largely report-based exercise, and recordkeeping and document storage have not been practiced by relevant agencies to the highest standards. This has resulted in a focus in this report on relatively high-level benchmarking in terms of the framework and the process of privatization. However, we are confident that our overall conclusions on that framework and process indicate that there are achievable solutions to making significant improvements in the important areas of policy, decision making, implementation, and process, in relation to:

- Transparency
- Public availability of information
- Clarity of transaction structure and process
- Higher financial returns for the GoG
- Greater investor quality and confidence
- Speedier and more efficient procedures in state bodies responsible for privatization

## **Recommended next steps for EPI beneficiaries (primarily MoESD):**

### 1. Framework: LSP and secondary legislation

Our proposals do not always require amendments to the LSP; subject to Georgian legal drafting conventions, they could be largely achieved by the GoG or MoESD amending or introducing new decrees, orders, or guidelines covering the following issues:

- Greater control and accountability of third parties involved in the privatization process
- Introduction of competitive tender bidding rules for sale of significant and/or valuable assets (potential EPI assistance project - see next section)

- Limitation on use of post-sale investment obligations to cases where these are necessary or fully justified
- Up-front cash sales with no installments or payment conditions to be used as widely as possible
- Disapplication of auction method to sales of shares in state-owned companies
- Simplification of granting of management rights in state-owned companies
- More independent oversight and scrutiny of privatization transactions

Please note that, according to the SoW for this project, the consultant was not required to include or take account of any environmental issues in the final report. To the extent that the recommendations set out below and elsewhere in this report have environmental aspects, all actions and steps to be taken for the implementation of some or all of those recommendations by the GoG will need to comply with relevant environmental treaties, laws, and regulations (both domestic and international), which apply in Georgia or which Georgia has agreed to abide by.

## 2. Recommendations for management and privatization process

- Compile a comprehensive state property inventory (potential EPI assistance pilot project)
- Implement one or more of the priority first-stage recommendations of the FORECAST E-Government Report relating to the proposed SPMIS (potential EPI assistance project) with specific subcomponents, including:
  - Establishment of electronic database of privatization contracts with automated monitoring of investment and payment conditions
  - Creation of a suite of standard e-documents for online execution (e.g., auction contracts and other sales contracts)
  - Electronic payment and notification system for registration at NAPR by MoESD of stage payments for privatized state property
- Initiate a private owners land registration drive to ensure registration and cadastral record of all unregistered land
- Instigate greater checks on prior land ownership claims before unregistered land is registered in state's name and auctioned
- Use direct sale method to sell adjacent/surrounded state land plots to sole users of those plots
- Initiate fast-track liquidation procedures for nonoperational or paper state enterprises
- Improve corporate governance of operational state enterprises (potential EPI assistance project)

### Recommended project actions for EPI:

1. Assistance in legislative drafting, e.g., application of international public tender procedures to direct sale using competitive selection method of privatization

Action: Prepare drafts of (1) amendments to LSP, (2) GoG Decree on Competitive Selection (Tender) Procedures, (3) contracts with third parties, and (4) other regulations as necessary

No. of days: 30-40

Start date: October 2011

2. Compilation of state property inventory—initiate a pilot project in a selected area (city/town/raion)

Action: Identification, boundary definition (GPS), and recording of data on all state-owned immovable property in one town or district for registration in NAPR

No. of days: Approximately 250

Start date: November 2011

3. Implementation of the priority first-stage recommended minimum outputs of the FORECAST E-Government Report relating to the proposed SPMIS<sup>1</sup> through the development and expansion of electronic resources at the MoESD

Action: Assistance in implementation of priority SPMIS projects, which will be selected after further evaluation of likely cost and feasibility of SPMIS and follow-up projects

No. of days: Approximately 250

Start date: [Following evaluation and approval]

Specific subcomponents of the proposed SPMIS, which have been indicated by MoESD as alternative/secondary priorities for implementation include:

- Establishment of electronic database of privatization and other state property disposal contracts with automated monitoring of investment conditions

Action: Technical implementation project for scanning of 1200 existing privatization contracts and creating automated alerts systems for upcoming conditions/payment deadlines in each contract

No. of days: Approximately 250

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<sup>1</sup> These are listed in the FORECAST Final Report in Section 3.5 as (1) creation of a unified state property database; (2) automation of processes of at least two MoESD divisions (e.g. DoSPMP, Privatization Department, EMA); (3) automation of overlapping processes ready for integration in any modules (state property registration, monitoring); (4) automated Web publishing and electronic data exchange with external data providers/consumers; and (5) fully functional Web portal providing both public and private functionalities

Start date: September 2011

- Creation of a suite of standard e-documents for online execution (e.g., auction contracts and other sales contracts)

Action: Drafting and technical aspects of online template contract documentation for all types of privatization and disposal

No. of days: 50

Start date: October 2011

#### 4. Improvement of corporate governance of operational state enterprises

Action: Preparation of corporate governance manual/rule book, with training courses and supervision of inspectors

No. of days: 40

Start date: November 2011

## **II. APPENDICES**

- A. BACKGROUND**
- B. FINDINGS**
- C. RECOMMENDATIONS**
- D. ADDITIONAL INFORMATION**

# A. BACKGROUND

## OVERVIEW OF PRIVATIZATION IN GEORGIA TO DATE

It is clear from any detailed review of the history of privatization in Georgia since 1992, when the process started in earnest, that Georgia initially took a similar path to most other newly independent states, which were formerly part of the USSR. The relatively slow speed of reform and change can be partly explained by the lack of democracy and the rule of law before 1991, evinced elsewhere in a tradition of private property and the sanctity of law and contract in relations between citizens and with the state. The Rose Revolution of 2004 gave a huge impetus to the reform agenda and it is clear that much has been achieved in the subsequent period.

However, it takes time to establish the fundamentals of democracy and the rule of law and missteps are inevitable—no country in the world which started from the same point got it right first time. However, many other countries learned and adapted (some faster than others) to the guiding principles, which underlie any attempt to transition from a command economy to a free market one by the mass transfer of capital from the state to the private sector:

- Fairness-equality of treatment for participants
- Openness-freedom of information
- Predictability of process—leads to more certainty of outcomes
- Rule-based actions-not arbitrary state decisions
- Consultation—with interested parties and representative groups
- Participation—of as many citizens and groups as possible

These principles can be summarized in one word—transparency. It is the keystone for a successful transition to, and entrenchment of, a private property-based society in which trust in leaders and the state is given a proper chance to flourish.

Before looking in depth at the application of these principles in Georgia today, it is necessary to briefly review the history and background in terms of the legal framework and process for the privatization of state property. We are focusing on state-owned land and state enterprises as being two of the key drivers for a transition to a successful market economy, and which today still represent the most significant areas requiring continued effort for completion of the privatization process in Georgia.

There is a dearth of reliable privatization data from 1992 to the present day, and available data is often conflicting and inconsistent. In addition, the state authorities responsible for privatization during this period have issued large numbers of laws, decrees, and regulations concerning privatization, many of which have been amended several times since enactment and some of which are hard to locate or have not been translated. Accurate information on privatization is not easy to obtain, often because different sources give conflicting data and information concerning the same matter.

This review will highlight verifiable privatization data and will cover the laws and regulations (translated into English), which are most relevant to this report and the objectives of this SoW.

# B. FINDINGS

## STATE OWNED LAND

### Summary<sup>2</sup>

Since 1991, Georgia has privatized ownership of both rural and urban land, principally in three waves.

The first was initiated by Decree 48 of 1992 and comprised the distribution (free of charge) of an estimated 763,000 ha<sup>3</sup> of agricultural land from 1300 collective/state farms to farmers (up to 1.25 ha each), rural households (up to 0.75 ha), and urban households (up to 0.25 ha), enabling them to produce food mainly for their own consumption. This transfer of c.25% of total agricultural land was affected by means of a kind of certificate<sup>4</sup>, which in and of itself gave the individual holder the right to own the land he/she had been given, but fell short of an actual title (i.e., a location on plan with surveyed and defined boundaries). Attempts were made to formalize title and registration throughout the 1990s, but by the end of that decade and despite modifications to law<sup>5</sup> and the efforts of donors to provide cheap and efficient registration, quality ownership remained elusive for a significant portion of rural landowners and the achievement of a uniform titling and registration system in Georgia was far from complete.

In the second privatization wave in the late 1990s, the state still owned around 2 million ha of agricultural land (including c.1.1 million ha of pasture land, which was not subject to privatization and to which local communities have access). The policy was then to use leasing arrangements to allocate operating rights to land to larger, commercial enterprises so that farmland could be utilized more efficiently. The original intent of the dual agricultural system—privately owned subsistence farms and large commercial farms on state-owned property—was not fully achieved and issues remained to be solved. Large farms were not utilized efficiently or profitably, while subsistence farms were often too small to be financially self-sufficient given the lack of support for intensive small farm production. Agriculture continued to decline as a share of GDP<sup>6</sup>, many rural households lived below the poverty line. Short lease-terms for state-owned land, for example, provided little incentive for investment or sustainable management. Private ownership of land is therefore fragmented and the

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<sup>2</sup> Data and extracts mainly from the Web site USAID Land Tenure and Property Rights Portal for Georgia <http://usaidlandtenure.net/usaidltp/products/country-profiles/georgia-1>

<sup>3</sup> UNDP, Green Fields Report and the Third Draft of a 2006 contribution to The Georgian National Food and Agriculture Strategy: 2006-2015

<sup>4</sup> In Georgian, this could be translated as ‘Receipt-Delivery Act’ which in many cases was not actually documented

<sup>5</sup> E.g., the Law on Land Registration of 1996 and Presidential Decree #327 of 1999 on the Urgent Measures for the Initial Registration of Agricultural Land Ownership Rights and Issuance of Registration Certificates to Georgian Citizens

<sup>6</sup> Unverified estimates claim that Georgia’s pre-independence agricultural exports to the USSR (official and unofficial) comprised some 10% of the USSR’s total consumption of such goods. Georgia now imports around 80% of its foodstuffs. If these figures are anywhere near accurate, it demonstrates a shocking decline in the agricultural sector in the last 20 years and the utter failure of the agricultural policies of successive GoG

average size of private farms is very small. Overall, labor productivity is low in the agricultural sector and the lack of effective collateral limits access to credit from financial intermediaries.

In 2005, the GoG began a new phase of privatizing agricultural land remaining in state ownership, both leased and unleased. Sales of unleased land by public (and now electronic auction) have accelerated, although there are still significant titling and inventory issues (discussed in more detail below). The existing lease arrangements (then covering around 40% of total state-owned arable and cropland) had not provided farmers and other investors the tenure security needed to encourage serious investments in agriculture. As a result, the GoG stopped the practice of farmland leasing, made lands already held under leasehold available for privatization and granted leaseholders preemption rights<sup>7</sup>. The aims of this strategy were to complete the land privatization process, create incentives for the establishment of efficient, large-scale farms, and increase productivity.

### Title and registration issues

Both the first and second waves of privatization were based on a certificate of ownership system entitling the holder to register title in his local cadaster. Due to difficulties with documentation and cost as described above, a significant number of certificate holders did not register. In the second phase, a new certification process was supported by the USAID LMDP Projects I and II (1997-2004), but problems arose with evidencing proof of legal boundaries and inconsistencies in the accompanying maps, which did not accord with the registration requirements, making it difficult to register title using the certificates.

One problem regarding registration of initially privatized rights had to do with faulty surveying: when survey data was transferred to electronic databases, the new records omitted the full extent of the land considered to be held in ownership for many plots. The government attempted to remedy this problem by adopting the 2007 Law on Recognition of Title to the Land Plots Possessed (Used) by Individuals and Legal Entities under Public Law, which gave the possessors of land held in good faith, land under use, and land seized or illegally owned rights to acquire ownership (in the latter cases, on payment of a multiple of the land tax payable on the property).

The NAPR was created in 2004, replacing the State Department of Land Management and the Bureau of Technical Inventory. Through its district offices, the NAPR provides simplified and cheap registry services for immovable and movable property, as well as a national real estate cadaster established in 2008 to replace the inefficient district (rayon) system. By 2006, the NAPR was self-financing due to increased registrations, a new fee structure, and fund retention and was able to introduce state-of-the art electronic database and online registration processes.

With the introduction of the NAPR in accordance with the Law on State Registry (2004) and the Law on Public Registry (2008), a comprehensive title registration and national cadaster system was put in place.

The current land registration system in Georgia is relatively inexpensive, simple, fast, and effective. The registration fee for land registration

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<sup>7</sup> Previously, under the Law on Privatization of State-Owned Agricultural Land (2005) and now formalized in the LSP in Arts. 7, 12 and 13

is GEL 50. To register the sale of land, the buyer must first pay the registration fee at a commercial bank and obtain a receipt. The buyer then must apply to the National Public Registry within 15 days of execution

of the sale with the required documentation (much simpler than under previous registration systems). The Public Registry may take up to four days to register the sale and issue an Ownership Certificate.<sup>8</sup>

However, the problems with older ownership claims arising out of the previous efforts to privatize land in Georgia are as yet unresolved. The NAPR registration and electronically mapped cadastral system depends on accurate surveying and using GPS coordinates in order to obtain precise location for electronic recordkeeping. So far, these maps only cover a small amount of the total cadastral land in Georgia. Plots cannot be registered and sold/purchased without having the required plans and GPS coordinates. This applies to both state land to be privatized, as well as the significant quantity of privately owned land which is still unregistered under the new regime. In addition, there are actual and potential disputes between the state and private owners over land plots which either overlap or have been the subject of an unregistered ownership certificate.

### Nonagricultural land

Privatization of nonagricultural land has been less problematic. It is more readily registered, marketed, and transferred. Urban property reforms were undertaken in 1997, five years after rural land privatization was initiated. Georgia's procedures for registering property—largely for urban-based industries—are now significantly simpler and less expensive than those of other countries in Eastern Europe and Central Asia. As of 2001, it was reported that 60% of commercial/industrial land, 100% of urban land with houses, and 90% of urban land with apartments had been privatized, but we have not been able to verify these figures or get reliable updates.

### General

The APLR, a nongovernmental organization that defends farmers' rights, has for many years played a major role in working with the government to get laws passed, monitoring the status of the reform situation, maintaining local records of property rights, and being active in an education campaign to inform farmers of their rights.

Foreign individuals and companies may buy nonagricultural land in Georgia; only Georgian citizens or companies may buy agricultural land. However, a corporation registered as Georgian that is 100% foreign owned may purchase agricultural land.

## TYPES OF IMMOVABLE PROPERTY

Of the four types of land covered by the LSP, forests are not strictly relevant to our SoW and we will therefore focus on the three other classes of land:

1. Unleased agricultural land
2. Leased agricultural land

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<sup>8</sup> According to MoESD Deputy Minister Giorgadze, the NAPR has recently been ranked the second best in the world

3. Nonagricultural immovable property (mostly commercial/industrial or urban land and buildings)

Taking each of these in turn:

1. Unleased agricultural land

Prior to 2004, the only state-owned agricultural land that was privatized was the initial free-of-charge distribution of land of collective and state farms. After the Rose Revolution, the new government changed this policy and initiated the necessary law changes<sup>9</sup> to sell off state unleased land as fast as possible. However, this process has been (and will continue to be) hampered by the fact that there has been no systematic approach to the registration of state land. As was pointed out to us by Deputy Minister, Giorgadze, as a budget-financed body, the MoESD will find it difficult to persuade the GoG to allocate the funding for this exercise.

While the early sales of state agricultural land took place by public auction, the introduction of the NAPR electronic registration system and the commencement of online e-auctions this year, where a cadastral code and map are required, means that this lack of registration of a substantial majority of state agricultural land is likely to slow up the sales program without necessary remedial action.

The government has taken steps to partly mitigate this problem by *inter alia*:

- Providing in the LSP for third parties (intermediaries or brokers) to initiate the surveying and registration of state-owned land, then submitting the land for auction and being paid out of the privatization price
- Passing registration of smaller plots of land (with a value <200,000 GEL) to municipalities which can then register their ownership at NAPR with appropriate documentation
- The MoESD is working with the Ministry of Agriculture and the APLR to identify and prepare plots of state agricultural land for sale and investment.

However, the MoESD does not have the resources to fund a widescale registration process for its own land, let alone provide solutions for private owners who cannot afford the relatively high costs of producing the necessary documentation to register their ownership. Continued donor support is required and one of the proposals of the EPI team is for a pilot inventorization project in one rayon.

This issue of lack of registration or cadastral mapping of previously privatized land is already becoming a critical one for the GoG—Deputy Minister, Chelidze, informed us of a rising number of court cases brought against new owners and/or the MoESD by aggrieved claimants holding certificates of ownership of land issued to them in the 1990s, but which have not been registered. In these cases, the MoESD has checked the NAPR for a piece of land, found no prior registration, assumed it is state owned and then subsequently registered that land and sold it at auction, after which the unregistered ‘owner’ came forward. With the NAPR registration program now expanding to the regions, this problem is going to arise more and more often, and is of course a severe investment risk for potential investors in

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<sup>9</sup> Law on Privatization of State-Owned Agricultural Land of 2005

privatized state-owned land. It is impossible to evaluate the scale of this problem, as the numbers of land plots which may be affected is not known accurately.

There is a clear need to make registration of all land ownership compulsory, but this is a huge undertaking and requires a massive amount of resources to complete.

## 2. Leased agricultural land

By 2004, approximately half of state-owned agricultural land was leased out, under which arrangements land was very often being inefficiently farmed, left to lie fallow, or stockpiled by those hoping to profit from eventual privatization. The new government decided to take action to require the leaseholders to buy the land at a predetermined price and if they chose not to, the land would be taken back by the state and sold as if it were state-owned unleased agricultural land. These arrangements were originally put into effect in the 2005 Law on Privatization of State-Owned Agricultural Land and more recently repeated under the LSP<sup>10</sup>. Leaseholders had, until 1 May 2011, to apply to buy their land at a fixed price per hectare, otherwise the lease would be terminated and the land sold at auction.

While the right to terminate a lease contract is not strictly expropriation and, therefore, a violation of the basic right to property ownership under Art. 21 of the Constitution, this does constitute statutory a form of violation of property rights and is inconsistent with the sanctity of contract under a democratic rule of law concept. If the lease contracts in any event contained a unilateral termination right on the part of the state or municipality which signed it, then it would be a simple ratification of that right. However, the fact that the LSP contains this provision indicates that the lease contracts did not contain such a right and perhaps in some cases that there was no formal contract at all (or that it has been subsequently lost). The buy it or lose it ultimatum, with no offer of alternatives or compensation of any kind for any investments which might have been made, seems to be *prima facie* unfair on those who do not want (or cannot afford) to exercise the purchase option.

This issue aside, the freeing up of leased land for privatization is one way, if a little draconian, of attempting to bring some rationalization and efficiency to smaller-scale farming. The MoESD estimates that there has been a very substantial take-up of the exercise of this option by leaseholders and that a relatively small amount of such land would be available for privatization once the compliant leaseholders have acquired their land.

## 3. Immovable property (mostly nonagricultural land and buildings)

As has been stated above, the privatization of nonagricultural land and buildings has moved at a much faster pace than agricultural land. Urban land, houses, and apartments formerly owned by the state have almost completely been transferred to private owners, in many cases to the persons and families who occupied them before independence. In addition, a relatively thriving real estate market has been developed on the back of some important work in cadastral mapping, titling, and registration of urban real estate, assisted greatly by donor-funded projects<sup>11</sup>.

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<sup>10</sup> Arts. 12(5) and (6)

<sup>11</sup> Cadastre and Land Register Project of Kreditanstalt für Wiederaufbau (KfW) (2000 - 2006): Funding of base aerial photographing, ortho-photo development, mapping, cadastral surveys and the establishment of six regional centres on the developed territories of Georgia. Urban Land Management Project of the German Technical

For commercial/industrial property, the large majority of this was registered with the respective state enterprises and entered into their balance sheets. Most of those enterprises have now been privatized (see discussion on enterprises below). The remaining state enterprises are mainly those which are bankrupt or merely paper companies with no activities or assets. We will be making certain recommendations with regard to those companies later in this report.

One of the remaining tasks to be carried out in respect of immovable property is the inventorization of the assets belonging to the state, in particular properties in Tbilisi and other urban centers. At present, there is no central asset register for state property and, therefore, the identification of assets and their subsequent registration prior to sale is a key part of the government's program for rapid privatization. Records of state assets are spread around many state institutions and the task of collecting these records and entering them into a central (eventually electronic) database is a huge one.

The MoESD is also reliant on private sector intermediaries, as with agricultural land, for the identification, surveying, and registration of state nonagricultural property prior to sale, for which the intermediary is paid a fee out of the privatization price. The MoESD has also entered into arrangements with around 10 reputable and internationally known firms of appraisers and auditors in order to carry out the valuation of property of a high value in urban areas. For properties of lower value, the MoESD uses around 50 appraisal firms or individuals who are certified through the APLR, which is accredited for this purpose by the state agency –Accreditation Centre.” This outsourcing of a necessary precursor to privatization should speed up the eventual sales of remaining state property. Again, these appraisers will be paid out of privatization proceeds.

### **Summary of key issues in relation to privatization process for state land and property**

1. Systematic identification and registration of state property. The newly-established electronic registry at the NAPR does not allow property to be sold without prior registration and allocation of a cadastral code number and a cadastral map. With no funding from central government for a comprehensive registration program for state-owned land, the MoESD (which is primarily responsible for the sale of state-owned land) has to find other solutions. These include the use of „third party” brokers or other intermediaries to initiate state land registration in return for payment of surveying and registration fees out of the proceeds of a privatization sale. Donor funding for pilot projects in particular districts is one possibility (see recommendations below).
2. Registration or sale of state property in conflict with prior unregistered private ownership. As has been pointed out above, the lack of registration by private owners of previously state-owned property which was privatized in the 1990s gives rise to a rising number of actual and potential court cases as and when the appropriate state body (e.g., MoESD) registers a piece of land prior to auction which, unknown to buyer and seller, is subject to an ownership certificate issued in previous times. This will also occur on the auction sale of a piece of land—a claimant may only come forward after the sale has been completed and the buyer registered as the replacement owner of the state. In those cases, the claimant could take action against both the buyer and/or the MoESD.

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Cooperation (Deutsche Gesellschaft für Technische Zusammenarbeit, GTZ) (2001 - 2004): Funding of cadastral surveying and registration activities in Tbilisi.

3. Need for a comprehensive (and ultimately electronic) database/inventory of state assets. It is clear from our researches that the state (and in particular the MoESD) does not know the full extent of its assets which it may have acquired preindependence and for which no registration or documentary record was made or kept. For those assets where records do exist, the records may be held by a variety of state bodies. There is a need to collect and collate information on all state-owned property (especially urban property) from the various bodies and places in which such information is held, and then to electronize the database so that it can be integrated and synchronized with the NAPR (see references to the SPMIS later in this report).

## STATE ENTERPRISES (PRIVATIZATION and MANAGEMENT)

### Privatization pre-2004

The process of privatization of state property in Georgia began in 1992 and was initiated primarily under Law on Privatization of State Enterprises of 1991. In the early stages, priority was given to the privatization of small and medium enterprises: the law copied Russia's approach to privatization by providing for several methods, including "popular privatization," consisting of a combination of vouchers distributed to the public<sup>12</sup> and auctions of state enterprises. Some 12,860 small-scale enterprises were reported as privatized between 1993-1998<sup>13</sup>, mostly by sale to their managers and/or employees.

The GoG's program for medium- and large-scale privatization only started in mid-1995. The buyout option for managers and employees was still the favored method of ownership transfer, but this was augmented by the voucher program of mass privatization, where at least 35% of shares were reserved for those who held vouchers from free allocation to citizens or through auctions.

The Law on Privatization of State Property of 1997 (30.05.1997; No 743-III) prescribed the methods (competition, auction, lease with redemption and direct sale) and procedures of privatization of state enterprises and their assets. This Law was amended in 2007 to extend its scope to nonagricultural land. The Ministry of State Property Management was then the state body responsible for privatization and management of state property.

In 1998, the GoG, with encouragement from International Financial Institutions and donors, such as the World Bank and USAID, began to focus on the privatization of large-scale enterprises, which included nearly all infrastructure companies. However, progress on this front was initially slow and by 2000, the majority of state enterprise equity still remained in state ownership, as most enterprises sold

before that date were relatively small with low asset values.

<sup>12</sup> Privatization vouchers with a face value of \$30 each were distributed to all of Georgia's citizens (except for those in the breakaway regions). They immediately started to be traded at a significant discount. Georgians could use the vouchers to bid for shares in companies being privatized or invest them in one of Georgia's 20 new investment funds. This kind of 'mass privatization' was tried in many transition countries in the 1990s and is now generally thought of as discredited. Problems often arose with unscrupulous individuals buying up vouchers cheaply, which allowed them to acquire stakes in enterprises 'on the cheap'. It is also accepted that voucher privatization is a very inefficient way of bringing good corporate governance and new investment into enterprises which may desperately need those things

<sup>13</sup> <http://www.fdi.net/documents/WorldBank/databases> (increased to 17,000 according to a 2005 EC Country Report)

Nevertheless, the wave of privatization of small- and medium-sized enterprises was generally regarded as a success (e.g., EBRD Transition Report 2000). During this period, the great majority of medium-to-large state enterprises were also ‘corporatized’ (i.e., converted into shareholding companies, either joint stock or limited liability) as a necessary precursor to privatization by sale of shares.

The sale of GoG stakes in large-scale enterprises only began to gather speed in 1999/2000. By 2003/2004, some major sectors had been addressed and the following table illustrates some of the significant transactions which took place in that period.

Year	Enterprise	Method of sale
1995	United Georgian Bank, Bank Sakartvelo, Agromretsvbank	Merger and joint venture (part-privatization)
1999	Kaspi (cement works)	Direct sale
1999-2000	Telasi Electricity Distribution Co.	Direct sale (international tender)
2000	Gardabani TPP	Direct sale (international tender)
2001	Batumi Oil Terminal (Ajara)	Direct sale
2003	Rustavi Azoti (Chemical company)	Direct sale (assumption of debts)

However, many of the transactions at that time were tainted by accusations of ‘cronyism’ or by the then-President’s close links to Russian investors. In addition, the Ministry of State Property Management announced auctions or competitions for the sale of majority shareholdings in a number of large state-owned industrial enterprises, but many failed to attract any bids at all<sup>14</sup>.

Apart from the electricity sector, where AES corporation acquired some of the distribution and generation assets in a public tender process designed and overseen by Merrill Lynch, and also the attempted (but unsuccessful) sale of two state-owned telecommunications companies with the assistance of the international bank Commerzbank, none of the privatization deals followed international best practice, even if the methods employed conformed generally to the provisions of the Law on Privatization of State Property.

#### Privatization post-2004

<sup>14</sup> The list included companies such as Elmavalmshenebeli, which manufactures electric locomotives; Kimbochko chemical fiber plant; Kolkhida truck manufacturer; Sakabreshumi silk factory; and Tbilgaz, the municipal natural gas distribution company serving Georgia's capital

The Rose Revolution in 2004 brought about a huge change in the official attitude to privatization. Under the energetic leadership of Georgian President, Mikheil Saakashvili, the administration launched an ambitious privatization program, in the first year of which the state disposed of nearly 200 enterprises, generating over USD300 million in revenues.

Alongside this program, the GoG launched the 'Georgian National Anti-Corruption Strategy',<sup>15</sup> which promised that the privatization of state property would be carried out *in accordance with the law*" and stated that the priority of the state would be to accelerate the sale of state property and enterprises *with maximal transparency*".

In 2006, the GoG also ensured the enactment into law of the Law on State Support of Investments<sup>16</sup> which, among other things, provided for the public availability of information relating to privatization by direct sale.<sup>17</sup> In addition, the Law stated in Art.8 paragraph 8 that *in order to ensure competitive selection, [GoG] shall publish information on the property and respective conditions in national and/or international media means and shall determine the term for submitting the proposals, which, as a rule, shall not be less than one month. In case if the delay can adversely affect the state and/or public interests, this term can be reasonably reduced by the decision of the [GoG], provided that availability of the information for public and investors will be ensured by other means*".

However, Art. 8 was rescinded by amendment to the Law in 2007, thereby removing an important requirement on the GoG to exercise transparency and openness in these matters. This Law, which is still in force, also allows the PoG to grant *special investment status*" to investors who agree to invest 8 million GEL, which status appears to offer the investor indirect, but unspecified protection from its own legislation and regulatory requirements of its state agencies.

Despite some concerns raised by observers of the privatization process during the period 2004-2010, the picture is one of overall success during some difficult economic and geopolitical times. The Web site of the MoESD which records all sales closed since 2004 (by whatever method) shows that there have been 1551 transactions to date<sup>18</sup>, the vast majority being sales of immovable property by public auction which is generally considered to be the most transparent method of privatization.

Furthermore, the GoG has declared that as soon as possible, all sales of state property will be conducted by e-auction and has suspended public auctions now that the e-auction Web site ([www.eauction.ge](http://www.eauction.ge)) has been operational since February 2011. Given that most state enterprises that were going concerns have already been sold<sup>19</sup>, the emphasis will switch to the sale of remaining state land (agricultural and nonagricultural). One major exception is the proposed sale of Georgia Post, which was announced in January 2011. Potential investors have been asked to submit their details and outline proposals for this company and there has apparently been a good response to date.

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<sup>15</sup> Presidential Decree #550 of July 24, 2005, followed by the Government Order #377 of September 12, 2005 — *Activity Plan of the Georgian Anti-Corruption Strategy*"

<sup>16</sup> 30.06.2006; No. 3424-rs

<sup>17</sup> For example, according to sub-paragraph 4(c) of Article 8, the direct sale could be implemented *on the basis of justification of necessity of using this form and with ensuring public availability of information*"

<sup>18</sup> As of May 27, 2011

<sup>19</sup> See following Section — *Management of State Enterprises*" for details of remaining enterprises

While it is true that privatization has made substantial progress in Georgia, it is important that the GoG recognizes that putting international best practice into effect in Georgian privatization, even now, will have beneficial effects politically and economically—transparent, well-designed, and conducted sales undoubtedly bring in more in terms of privatization proceeds than the less transparent and inefficient methods that have applied in the past, and the public will more readily accept the results if transparency is embedded in the process. This principle is at the heart of the recommendations made later in this report.

### **Management of state enterprises**

The EMA was established under the 1997 Law on State Property Privatization as a budgetary LEPL, reporting to the then Ministry of Economy, Trade, and Industry (now the MoESD). Its role was then, as now under the LSP, to manage the shareholdings in all state enterprises, most of which by then had been corporatized. Under both the 1997 Law and the LSP, the Ministry itself was given the authority to dispose of the shares and stocks in state enterprises.

The primary functions of the EMA are:

- Approval of annual state enterprise business plans
- Receipt of six-monthly financial reports
- Monitoring of compliance with law by state enterprise directors (who are required to enter into contracts with EMA with penalties for noncompliance)
- Preprivatization restructuring of enterprises (surplus assets sales, workforce, and salary bill reduction etc.)
- Merger of enterprises
- Liquidation of enterprises with few or no assets or liabilities (paper companies)
- Bankruptcy of insolvent enterprises under the Bankruptcy Law (through the courts) where the enterprise has assets and liabilities

There are 1,167<sup>20</sup> state enterprises under the supervision of the EMA today, down from c.1,500 in early 2010 when the current management of the EMA was appointed. The large majority of these enterprises are 100% state owned, with very few having less than 50% equity in state hands (see table below). These stakes are an obvious candidate for immediate sale when the enterprise is profitable.

In the period 2003-2010, some 20 mergers and 25 liquidations of state enterprises were completed – in the last 12 months alone, there have been 12 mergers and 51 liquidations completed, and a further 60 liquidation procedures commenced. In addition, two bankruptcies have been completed and another seven are in process. It is clear that swift progress has been made recently as compared with prior years. The chairman of the EMA also tells us that certain procedures in liquidation and bankruptcy have been shortened or speeded up through changes to the LSP in the last 12 months (e.g., in the auction process of assets sales), which has had a beneficial effect on the rate of progress in reducing the number of state enterprises and the net fiscal burden on the state budget.

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<sup>20</sup> As at May 31, 2011. Figures in this section (including the table) supplied to us by the Chairman of the EMA

The breakdown of the type of enterprise under EMA supervision is as follows:

Type of enterprise	Number currently under EMA
Operational (profitable)	218
Operational (nonprofitable)	265
Nonoperational ( <u>p</u> aper' companies)	607
Under liquidation	52
Under bankruptcy procedures	7
Where state share is less than 50%	18

We understand from EMA<sup>21</sup> that the procedure for enterprise liquidation can take place outside the courts, and is therefore quicker—a simple liquidation can take one month, a more complex one 12 months (the law stipulates four months). Although there is interaction between the EMA and other government agencies (e.g., the Revenue Service), liquidation is mainly an internal ministry process. The liquidator is a member of the Restructuring and Liquidation Division of the EMA, for example, which is unusual—in many other jurisdictions, the law requires an independent and specialized liquidator be appointed.

According to the Law on Bankruptcy Proceedings, if the state is owed more than 75% of the total debts of an enterprise, it can liquidate the company without creditors' approval, subject to the obligations to pay debts according to the priority ranking for bankruptcies under the Law (see below).

Bankruptcy proceedings must take place, through a court process, in accordance with the Law on Bankruptcy Proceedings. There are seven enterprises undergoing bankruptcy proceedings in the EMA at present, with some still going after five years.

While it is not possible to significantly shorten bankruptcy proceedings, there may be scope for enacting into law a fast-track' liquidation procedure in certain circumstances, where the enterprise is nonfunctioning and only has one or two saleable assets. In this way, some of the hurdles to quick liquidation can be removed, without materially affecting creditors' rights. For example, the law gives creditors rights to have an asset transferred to them if it is not sold in either of the two required auctions. This causes potential clashes with the ranking of priority creditors. Where the state is a creditor for >90% of the debts, it can be argued that the MoESD should have even more control over the liquidation process.

We also believe that there is more scope for improving both the financial performance and the corporate governance of state enterprises. While the business plan approval and

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<sup>21</sup> According to oral information on the Law on Bankruptcy Proceedings of 1996 (amended many times since, lastly in 2010) which we have not been able to review as there is no English translation available

financial reporting functions demonstrate a throwback to earlier, less free market times, and could well be reshaped or axed altogether, the other (more mechanical) functions are largely necessary and relevant to the scope of the EMA objectives. Improving the corporate governance of state enterprises is one area where work can be done relatively quickly and easily, e.g., by the introduction of a mandatory manual or handbook of corporate governance requirements in key areas, such as directors' fiduciary duties, conflict of interest, etc.

## **REVIEW OF THE LSP WITH RECOMMENDATIONS FOR IMPROVEMENT**

### **Summary of the LSP<sup>22</sup>**

This Law regulates the management, disposal, and transfer (with right of use) of all state property in Georgia. This law has replaced (and repealed) four laws that prior to the LSP had regulated the privatization of different types of state-owned asset, which are now dealt with and consolidated under the LSP:

Law on Privatization of State-owned Agricultural Land (2005)

Law on Privatization of State Property (1997)

Law on Disposal of Property Placed under State Ownership (2009)

Law on Transfer with the Right of Use of State-owned Property (2009)

The principal categories of state property covered by the LSP are as follows:

- Immovable property, divided into:
  - Unleased agricultural land
  - Leased agricultural land
  - Forests (former kolkhoz and sovkhos within boundaries of a settlement)
  - Immovable property (land and buildings, mainly in urban areas)
- Movable property, either:
  - Placed under state ownership (through seizure, bankruptcy, donation etc.), or
  - Entered into the balance sheet of a state body
- Intangible property, principally stocks and shares in state-owned (or part-owned) legal entities

The principal methods of disposal of state property are either:

1. Privatization (sale) by auction (electronic or public<sup>23</sup>), direct sale, and direct sale using competitive selection method

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<sup>22</sup> Copy English translation of the entire LSP is attached as Annexe 2

<sup>23</sup> We understand from the MoESD that public auctions have been suspended from 1 May 2011 in favor of all-electronic ones – not clear how this impacts sale of forests which can only be sold by public auction under the LSP

2. Transfer with rights<sup>24</sup> e.g., of use, management, distribution, sale, destruction

Table 1: Key elements of privatization or disposal of each type of state property:

Type of state property	Initiation and disposal method	Key process elements
Unleased agricultural land (Arts. 7-10)	(1) Auctions initiated by MoESD or by potential buyers or by brokers (third parties) (2) Direct sales carried out by decision of PoG	(1) Buyers and brokers must make cadastral drawings and plans if they initiate; initial auction price set by GoG on individual basis (2) Competitive selection method only required where investment conditions apply or if multiple bidders; no price-setting rule for direct sales; 5% advance or bank guarantee required, but PoG has absolute discretion whether to apply some or all competitive selection measures
Leased agricultural land (Arts.7, 12, and 13)	Direct sale only, lessee has right to buy on basis of lease agreement and applies to MoESD	Initial price set by GoG on individual basis; if lessee fails to apply to buy [by May 1, 2011], MoESD can sell land as if unleased land; MoESD also has unilateral right to amend or terminate a lease
Forests (Arts. 14-17)	Public auction only; MoESD organizes auction and approves the privatization plan	Restrictions on use and protection of environment are preconditions for privatization; initial auction price fixed in the LSP; local citizens have preemptive right to buy forest if buyer at auction subsequently sells
Immovable property (other than leased/unleased agricultural land) (Arts. 18-23)	(1) Auction carried out by MoESD (2) Direct sales (with or w/o competitive selection) carried out by MoESD on basis of decision of PoG	Property leased pre-2007 can be sold by direct sale to lessee @ 5x annual market rental value (independently certified); privatization price of unleased property by direct sale is approved by PoG, set by the Sakrebulo @ market value and paid in lump sum or installments; sale under investment conditions requires advance/bank guarantee of 10%

<sup>24</sup> 'Transfer' is translated from the Georgian as 'handover of property with right of possession' i.e., not transferring ownership. Note that the transfer with rights of use or management of most state property may also be carried out by auction and direct sale

		value of investment
Movable property placed under state ownership (Arts. 24-31)	MoF and the Service Agency established by MoF have overall responsibility for management and disposal; privatization methods include auction (e- and public), direct sale, online shop and one-to-one negotiation	Terms and conditions for price-setting, disposal, and distribution laid down by MoF, approved by PoG; seller is state body which has ownership or right of use; legal entity of public law (state agency) can only dispose with approval of governing body; sales can be done using third parties (brokers)
Movable property entered on the balance sheet of a state body (Arts. 32-38)	State property (movable <sup>25</sup> and immovable) can be transferred with right of use, via auction or without auction, to other state bodies, state agencies, natural persons, and legal entities of private law	Transfers to state bodies, state agencies, and municipalities are free of charge; those to natural persons and legal entities of private law will be subject to payment, the price to be approved by PoG; property subject to transfer with right of use cannot be mortgaged, pledged, or encumbered
Intangible property (shares and stocks of companies owned or partowned by the state) (Arts. 39-45)	MoESD is authorized to dispose of this property by (i) privatization— auction and direct sales, and (ii) transfer of the shares and stocks with RoM <sup>26</sup> ; note that MoESD controls the EMA to which state-owned shares are [to be] transferred (ownership)	Privatization: auction can be with/without conditions; direct sales to be carried out on the decision of the PoG  Transfer of shares with RoM: either by auction or via direct transfer on PoG decision  MoESD to draft respective privatization and transfer with RoM forms; rule for setting the privatization price of shares to be approved by PoG

<sup>25</sup> Excluding property placed under state ownership – see Art. 37(1)

<sup>26</sup> The Georgian word for transfer in this context has the same meaning as for transfer with right of use – a possessory right only.

The LSP sets out other key principles of disposal of state property, such as:

- Nature and any prequalification requirement of the buyer of each type of state property (Art.3)
- List of state property not subject to privatization (Art.4)
- Conduct of privatization transactions e.g., initial price setting, contract signing, payment terms, investment obligations (Arts 3(1), 9, 12, 13, 19, and 20)
- Main rules on auction method including publication of information (Art.5)
- Preconditions of participation in auctions e.g., bank guarantees/advance payments (Art.6)
- Role of third parties in privatization transactions and their payment out of sale proceeds (Arts.6(1), 7, 8, 31(5), 45(4))
- Key roles of the President, GoG, MoESD, and MoF in decision making and responsibility for conducting disposals (Arts. 3(1), 7, 10, 12, 13, 18, 18A, 24, 27, 28, 31, 40, 43)
- Rules for transfer with right of use of state property to state bodies, individuals, and legal entities (Arts. 32-38)

Secondary legislation in the form of Rules, Orders, and Decrees for the implementation of relevant provisions of the LSP have been issued (or are in the process of being redrafted following the amendments to the LSP during 2010 and 2011) by various bodies in accordance with the LSP. The following items of secondary legislation have been reviewed:

- President of Georgia Decree No 659 On Approving the Rules for Determining the Price for Privatization and Handover for Enjoyment of State-owned Property August 19, 2010
- Order N 1–1/1487 of the Minister of Economy and Sustainable Development of Georgia on the approval of the Regulation on the Disposal of the State Property Via Public Auction of September 7, 2010
- Order N 1–1/1537 of the Minister of Economy and Sustainable Development of Georgia on the Approval of the Regulation on Privatization Via Direct Sale of the State Property of September 16, 2010
- Order №1-1/172 of the Minister of Economy and Sustainable Development of Georgia on Approving the Rules on Holding e-auction when Disposing Government property, February 10, 2011

Much of the texts of these items of secondary legislation consist of reiteration of sections of the Articles of the LSP that are relevant to the subject matter of the secondary legislation in question. The remaining text provides some details on procedure which are not in the LSP itself, but are mainly noncontroversial. We do not propose to review these items individually, but any comments that we do have on relevant aspects of this secondary legislation are incorporated in this report and referenced as such.

The LSP has been drafted by Georgian draftspersons and follows the Georgian legislative norms, principles, and standards evident in other pieces of legislation which we have seen and reviewed. We make no comment or judgment on whether the LSP is or will be successful in terms of (i) the application of those legislative norms, principles, and standards, (ii) the achievement of the goals and aims of the GoG, (iii) the repeal and replacement of

relevant prior legislation, (iv) the remedying of past policy and execution missteps, or (v) the quality and effectiveness of the legislative drafting. Our task is to benchmark the key provisions of the Law in relation to the privatization process against similar legislation in other jurisdictions in terms of international best practice, where we believe that such practice (if applied in Georgia) is more likely to produce the business-enabling results, which the EPI has been mandated, namely to expand and deepen Georgia's economic governance capacity and country-level competitiveness.

The following are our high-level comments on the LSP, which highlight perceived gaps between the rules, procedures, and powers laid down in the LSP (as further developed in the secondary legislation) and those which we believe are best practice in a privatization process as applied in other countries which have implemented large-scale privatization programs.

As we have noted in Section 1 above, much of the Georgian state sector has already been privatized, both pre-Rose Revolution and between 2004 and 2010, when most of the remaining state enterprises were sold. The principal categories of state-owned asset still unsold are (i) agricultural land (ii) other immovable property in urban areas and (iii) remaining state enterprises. Issues relating to these categories of asset are explored elsewhere in this report.

*It is important to note that, in most cases, the issues we highlight can be resolved or ameliorated (if not eliminated) by means of either (i) amendments to the LSP itself or (ii) by additional secondary legislation (or the publication of supplementary guidance). We understand that the LSP is due to be resubmitted to Parliament in the near future with some amendments to be proposed by the MoESD. We have not seen those amendments when reviewing the law.*

#### Recommendations for improvements to the LSP

The 11 high-level issues of principle and process arising from the LSP and highlighted in this benchmarking exercise are:

- (1) Role of third parties
- (2) Discretionary powers
- (3) Use of direct sales
- (4) Development of capital markets–use of IPO
- (5) Initial price-setting vs prices achieved
- (6) Investment obligations
- (7) Use of auction method to sell shares in companies
- (8) Transfer of shares and stocks with management rights in companies
- (9) Disenfranchisement of rights of leaseholders
- (10) Oversight and scrutiny of disposals
- (11) Transparency

Taking each of these in turn:

1. Role of third parties<sup>4</sup>.

The LSP gives a potentially significant role in the privatization process to “third parties”, defined in the law as *“natural person[s] or legal entit[ies] or union of entities seeking the persons who wish to privatize the state property and, by initiating the privatization, supporting the process of privatization of the state-owned immovable property and performing his/her duty on the basis of the contract signed with the Ministry (MoESD)”*.

There is certainly a role for intermediaries and advisors to the state in any privatization process, and we have seen that in land privatization for example, the state has entered into arrangements with valuers (and auditors) that play an integral and important part in the process, as we have described elsewhere in this report. However, the definition of “third party” in the LSP is a very general and vague description of the type of intermediary and the tasks they are to carry out in the Georgian privatization process. This in turn gives rise to fears that such arrangements could open the door to corruption, especially since Art. 6 clearly provides for the reimbursement “out of the privatization price” of third parties for services rendered, based on a contract signed with the MoESD.

Further provisions of the LSP<sup>27</sup> describe the right of third parties to a contract and to be paid for their services, but we have not located any provision for controls or limitations of the following kind:

- Procurement rules or competition procedures to apply to appointment of third parties in appropriate circumstances
- Guidelines or limits on the amount of reimbursement such persons are entitled to charge and collect
- Restrictions on the payment of third parties by anyone other than the state counterparty
- Minimum specifications and requirements for the kind of services to be rendered and the standards under which such services are provided
- Requirements for professional qualifications or membership of/accreditation or registration with a professional body
- Publication and appropriate scrutiny of the contractual arrangements

The Draft MoESD Order “On the Approval of the Rules and Terms and Conditions of the Initiation by Third Parties of the Privatization of State-owned Agricultural Land” that we have reviewed does not deal with any of these important issues. Furthermore, third parties may have significant involvement in sales of other assets, such as enterprises and the rules relating to their contacts and terms, and conditions should be clear and transparent to all.

In our experience, arrangements for payment of a state seller’s advisors (in some cases directly to the advisor by the buyer) out of privatization proceeds can give rise to issues of conflict of interest on the part of the advisor and while such arrangements have been made in individual transactions in other countries on an *ad*

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<sup>27</sup> E.g., in Arts.7(7), 7(8), 18(4), 27(6), 31(5), 45(4)

*hoc* basis, we have not seen these types of arrangements formalized to such an extent by law as we see in the LSP. Even if the conflict is perceived rather than actual, questions can still be raised about the fairness and transparency of the process, and potentially about the probity of the MoESD, if the measures outlined above are not adopted.

Of course it is normal for sellers of state assets, in particular shares in state-owned enterprises, to utilize the services of advisors, such as valuers, auditors, investment banks, lawyers, and technical experts where such advisory services are necessary. The services described in Arts. 7(7), 7(8), and 8(4) of the LSP (making cadastral drawings and surveying land) are also a clear example of a function which needs to be performed by such experts. However, the general lack of suitable parameters and limitations to the hiring of „third party” advisors in the LSP is on our view not in accord with international best practice and action should be taken to lay down some minimum guidelines to prevent abuse and increase transparency.

**We recommend** that the LSP be amended in Art. 6 by the addition of a provision requiring the MoESD or the GoG to draw up suitable rules and regulations concerning the appointment and contractual arrangements of third party advisors and experts in all methods of privatization and disposal, not just for agricultural land, in order to improve transparency, prevent abuse, and to ensure, in particular, that responsibility for payment for services rendered is primarily with the client ministry and not with the buyer.

## 2. Discretionary powers.

It is best practice in legislative drafting and implementation procedures in democratic jurisdictions to minimize as much as possible the use of discretionary powers to be exercised by state bodies or government authorities. Persons relying on statutory powers and legal procedures should, as far as possible, be able to rely on due process, predictable outcomes, transparency, and equality of treatment, which should be clearly enshrined in a country's laws and regulations. The LSP contains a significant number of instances where a state body or office retains discretionary power, which is not circumscribed or clearly defined, to decide on the type of sale and the rules and conditions applicable to such sale in an individual case. In particular, the LSP grants to the PoG or the GoG such discretionary powers in the following circumstances:

- Under Art. 7, decisions on holding a direct sale with or without using competitive selection method
- Under Art. 10, decisions on (i) the winner of a sale of unleased agricultural land using competitive selection method (no grounds prescribed for that decision) (ii) conducting a direct sale using competitive selection method without going through the procedures prescribed in the Article and (iii) amount of land parcel and payment terms for direct sale of unleased land
- Under Art.18(3), the same powers as for Art. 10 in the cases of direct sale of state-owned immovable property
- Under Art.20(1), reduction of investment guarantee

- Under Art.42(2), direct sale of shares under the same conditions prescribed under Art. 10 (e.g., discretion to dispense with competitive selection procedures)

While a certain level of expediency or flexibility is often desired by those in charge of a privatization process, the drafting of the LSP leaves open the opportunity (or the perception thereof) for decisions by PoG or GoG to be made in individual cases which are not clearly based on due process, fairness, or transparency. The role of the PoG (and to a lesser extent the GoG) in the decision-making process of privatization in Georgia is also much greater than is normally found in other countries undergoing the same type of program, perhaps understandably because of the sensitive and complex nature of the history of privatization in this country.

However, we are strongly of the opinion that the scope of these discretionary powers should be defined and limited in order to ensure a higher level of certainty of process, outcome, and equal treatment. This will also reduce the potential for criticism from outside parties that powers are being exercised for reasons other than the national interest.

We recommend that this could be achieved through the transparent application of publication and scrutiny procedures for all decisions, which are made under the discretionary powers. For example:

- More definition and clarification of the special cases in which such powers are to be exercised
- GoG/PoG should issue guidelines on how and when they will exercise their powers
- All decisions in exercise of these powers to be published in the Official Gazette/24 Hours newspaper (as auction sales are currently announced)
- The reason and grounds for all such decisions also to be published
- Decisions will be subject to after-the-event scrutiny by an independent specialized audit/control body (see Issue No. 9 below)

These measures should ideally be included in the LSP as an amendment, probably as a separate new Article. Alternatively, they can be incorporated in a Presidential Decree or Order to be drafted and approved later, in accordance with an amendment provision in the LSP.

### 3. Use of direct sales.

The LSP defines privatization as “...*the acquisition of ownership of state property.....in the forms of electronic and/or public auction, direct sale, direct sale using competition selection method.....*”.

The expression direct sale is not itself defined in the Law, but it can be taken to have the meaning commonly used in privatization legislation in other jurisdictions – the entering into by the state seller and a buyer of a contract for the sale and purchase of the shares (or assets) of a state enterprise.

A simple direct sale according to prior experience in Georgia is used where there is only one interested party in a piece of state property, or where the GoG (more specifically the PoG in his discretion-see Issue 2 above) decides on this method. As we have noted above, the use of direct sale with or without the exercise of this discretionary power straightaway gives rise to concerns about transparency and due process.

A direct sale using competition selection method under the LSP does not conform to the transparent public tender model, which is commonly used elsewhere in the world.<sup>28</sup> The classic tender method envisages that the shares or assets will be offered for sale by public notice, on terms and conditions specified in a set of tender documents that are circulated to all bidders who prequalify or submit an expression of interest. Qualified bidders are given time to carry out due diligence and prepare and submit their bids according the tender rules. Bids are then evaluated according to the rules of the tender, before a successful bidder is selected under predefined evaluation criteria to sign the sale and purchase contract.

We have provided for information in Annexe 3 to this report a list of key principles and procedures, which apply in a typical international public tender in most jurisdictions in the world.

Where auctions are not used in asset sales,<sup>29</sup> the LSP (and the Ministerial Order No 1537 of September 16, 2010 (Statute on Privatizing State Property by Direct Sale) issued under Art. 46(4) of the LSP) describe and codify an *ad hoc* and reactive regime for direct sales (with or without using the competitive selection method). The procedures set out in the LSP and the Order are not nearly robust enough to be effective or transparent. While the use of direct sales has fallen away dramatically in recent years (see MoESD Web page - recently closed sales), the LSP gives the PoG the discretionary power to decide himself on the sale of many categories of state assets, including the power to dispense with the competitive selection procedures if he considers it appropriate, even where there are multiple offers (Art. 10(9))<sup>30</sup>.

In summary, there is no case under the LSP where the state seller is required to initiate a tender by public offer for the sale of an asset under the classic public tender model—the only rules for competitive selection methods are set out in Art.10 of the LSP and as noted in (2) above, the PoG can effectively suspend some or all of those measures.

Immovable property (land and buildings), which comprise the majority of state assets (by number and value) remaining to be privatized in Georgia, should generally be

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<sup>28</sup> More informal tenders can also be successfully applied, where for example a number of identified potential buyers are asked to prepare bids based on a limited set of criteria and conditions, and the state seller then decides between those bidders on the basis of a predetermined evaluation process (e.g., on price alone). Tender can be single-round or multi-round procedures, depending on whether the seller assesses that a higher price can be achieved by utilizing a more formalized auction process.

<sup>29</sup> By decision of the PoG – Art.7 of the LSP

<sup>30</sup> In the case of leased agricultural land (Art.12(2)) and other immovable property (Art 18A (2)) direct sales are the only privatization method, where existing lessees have a pre-emptive right to acquire their leased land. The rules for direct sales by competitive selection in Art 10 also apply to the privatization of all other state property by this method

sold by auction and we understand that this is the preferred method of the GoG. We have noted above the lack of a comprehensive inventory of state property, and the additional problem of unregistered state land, and the preparation of an asset inventory should be a priority of the GoG, as should be a land registration drive.

Any privatization transaction which does not conform to the principles of openness, transparency, and fairness is *prima facie* not in line with international best practice.

We believe, therefore, that the direct sales method of privatization can be significantly improved by applying many of the principles used in the classic public tender method (see Annexe 3), in particular for state enterprises and state property, which have the value and the potential to be sold into a market with multiple potential buyers.

**We therefore recommend** that the LSP be amended so that (i) direct sales using the competitive selection method are limited to those which are justified as special cases<sup>31</sup> and notified publicly in advance of a proposed transaction (ii) the LSP also provides for sales of state property above a certain size or value by direct sale under applicable public tender rules, and (iii) the MoESD issues a suitable secondary legislation containing those rules and principles.

#### 4. Development of capital markets via IPO of shares in state companies

There is no provision in the LSP for a sale of shares in state enterprises by flotation or public offering. It is common in other countries to give this option by law, especially where there exists a functioning stock exchange. In Georgia, the stock exchange has been operational for over 10 years, but few companies have their stock quoted and the daily volumes of share transactions are very small. Despite this, the sale of shares in the larger and more profitable state-owned companies presents an opportunity for the development of capital markets, in order to widen share ownership and assist the institutional investors such as insurance companies and pension funds in the early stages of their development in Georgia. Without making this a strong recommendation, and provided that there are still suitable state company candidates for IPO method in Georgia, we believe the GoG should consider whether this policy is a viable one and if so, to make the necessary amendments to the LSP.

#### 5. Initial price setting vs prices achieved.

For each type of state property to be privatized or disposed of by transfer with right of use under the LSP, the price to be paid (or in the case of auctions, the initial price) is determined according to a decision of the PoG. In only two cases (state-owned leased and unleased immovable property under Arts. 18A and 19), there is any provision in the LSP for the involvement of outside bodies in the price-setting process.

The Decree No. 659 of the PoG of August 19, 2010 (On Approving the Rules for Determining the Price for Privatization and Transfer of Use of State Property) sets

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<sup>31</sup> We can envisage these cases to include: where only one bidder comes forward in a public tender; an asset for which there is only one possible buyer (a plot of state-owned land which is surrounded by land owned by a private owner); a buyer of a state enterprise in a sector (e.g., defense) is from a country for which strategic national interests require a tie-up

out the rules in relation to state property disposed of under Art.19(1) (immovable property), Art. 31(1) (movable property), Art.38(1) (transfer with rights of use), and Art.45(1) (shares and stocks). In all of these cases (except shares and stocks, which shall be decided by the PoG), the Decree gives the relevant state seller the option to base its valuation on the conclusion of an independent auditor (expert) – it is not a requirement however, as the seller can also take account of residual book value in its decision, and the PoG also has the power to set the relevant price.

Clearly, where state assets are being sold by auction, the market will ultimately determine the final price. We also understand that the MoESD's practice is to obtain valuations for setting the initial auction price from accredited or contracted appraisers, at least for larger assets.

However, in the case of direct sales of larger or more valuable assets, including shares in state enterprises, **we recommend** that the LSP be amended (perhaps via an amendment to Decree 659) to make mandatory the use of initial independent valuations of those larger or more valuable state assets, in order to ensure that the assets are not being undervalued at the commencement of negotiations and, therefore, reducing the risk of them being sold at significantly less than market value. These valuations can be in the form of a valuation range, rather than a specific price, with provision for post-event scrutiny should the achieved price fall significantly outside the valuation range. This is particularly important in the case of privatization of shares and stocks under Art. 45, where it is a more complex process to value an enterprise which may have a basket of assets and liabilities (debts) affecting the overall value. For this reason also, we are recommending that auctions are not used to sell shares in state-owned companies (see Issue 7 below).

#### 6. Investment obligations vs cash sales.

The imposition of investment conditions in privatization transactions was popular with state sellers in the 1990s in Central and Eastern Europe and elsewhere. It was considered politically and socially important to protect workers jobs or to impose (sometimes arbitrary) social plans or cash investment obligations on buyers of state companies, especially those with strategic importance. In many cases, this approach lead to lack of buyers and/or lower prices paid for such assets. There was also a hangover from the command economy days, with politicians seemingly conditioned to maintain control of newly privatized enterprises as if they were still state owned.

It has become less of a common practice in the last 10 years, especially in countries where privatization has largely taken place, free market practices have taken hold, and the remaining assets are not of the type for which investment obligations are appropriate or strictly necessary. These conditions certainly seems to apply in Georgia, where land and buildings comprise the majority (in value at least) of state assets still to be privatized and where the only enterprises left to sell (other than a few asset-backed, utility, and public service companies, such as post, railways, and gas transportation) are those which are insolvent or which are paper companies.

The LSP envisages the use of investment conditions on the sale of state-owned immovable property (Arts. 19/20), which would not appear to be a class of asset on which such conditions would normally be required. Unless such property is of special architectural importance or has some other historical value (e.g., the Georgian Parliament building which is due to be sold), we believe that buyers should be left to

restore and/or develop land and buildings according to supply and demand market principles, subject of course to relevant local or national planning and environmental laws and any building regulations which may apply.

As the GoG moves to an e-auction based program of asset sales, we believe that the emphasis should be on achieving the highest up-front cash price for the asset sold, with no installment payment basis and with investment conditions imposed in as few cases as possible. Going forward, this will also help solve the investment monitoring issue for the MoESD, which is discussed in the following section, although the historic problem still needs to be dealt with.

For enterprises to be privatized or subject to transfer of shares and stocks with right of management, there are no provisions in the LSP for investment conditions to be imposed or applied, which is surprising given that some of those enterprises provide public services, for example. As a matter of policy<sup>32</sup>, some of those enterprises should be sold subject only to negative restrictions relating to the existence and continuation of the business, such as (i) requirement to continue (and not cease) the business for a requisite period, (ii) not to liquidate the enterprise, and (iii) not to dispose of the enterprise or cede control of it for a stated period—in each case without the prior written permission of the state body responsible for the sale.

**We recommend** that, both as a matter of policy and in order to simplify the process:

- (1) Investment conditions and obligations be used only when appropriate and necessary, and
- (2) Cash sales for up-front payment, with no installments or other conditions, should become the norm.

#### 7. Use of auction method to sell shares in companies.

It is unusual to provide for sales by auction of shares and stocks in enterprises (companies) where information on those companies is not publicly available (e.g., from being listed on a stock exchange). As mentioned under Issue 5 above, enterprises will often be a complex basket of assets and liabilities, which do not often lend themselves to a simple valuation and bidding process. That is why competitive bidding through public tenders is more commonly used, unless the companies have no assets or liabilities – in this case, a paper company might be sold by auction as a shell company (it may have a brand value in the name, for example). In the case of the assets of an insolvent enterprise, auctions can also be appropriate, but always bearing in mind the legalities of the insolvency or bankruptcy process in Georgia and the necessary protection of creditors when conducting such sales.

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<sup>32</sup> Other appropriate or necessary investment conditions can be considered on a case-by-case basis, depending on the nature of the business being sold and its position as e.g., a provider of public services with a universal service obligation (such as post). As we have noted in Annexe 3, in sectors where there is no proper competition, it is critical that adequate regulation be retained to protect the public from monopoly powers and to foster competition. The abolition by the post-2004 government of a swathe of regulatory agencies such as the Anti Monopoly Commission may have seemed appropriate at the time to the free marketers in government, but the risks inherent in (re-)creating unregulated new monopolies from old state industries can have serious economic consequences

**We recommend** that the MoESD does not use the auction method for the sale of shares and stocks, except in those instances where the company does not have any significant assets or liabilities. It would be advisable to amend the LSP to reflect this recommendation, although the decision on the privatization method is one of policy under the LSP.

8. Transfer of shares and stocks with management rights in companies.

In our view, this is a highly untypical method of disposal of a company, or even the right to manage a company. It appears to be similar to the 'transfer with right of use' method of disposal of other state property, but we would argue that in the case of shares and stocks, an outright sale of shares is the appropriate method of disposal—if the state wishes to retain ownership of the enterprise but wishes to bring in external management expertise for a limited period of time for turnaround purposes to improve business performance, then the appropriate way to do this in most other countries would be a simple management contract between the state company, the state (as owner), and the management company. This would not involve any transfer of shares or ownership rights. The contract would entitle the new management company to exercise all key rights of management over the enterprise, with business-building and profit-increasing incentives, in return for a fixed management fee and perhaps a share of the profits generated by the achieving of targets. It is not necessary to grant any rights over the shares, such as dividend or voting rights, as the new managers would have their rights enshrined by contract, separate from ownership.

**We recommend** that the LSP be amended to delete from the law all provisions relating to the transfer of shares and stocks with rights of management of a company. If state bodies wish to contract out the management of a company, they can do it as a matter of simple contract law without any impact on the state's underlying ownership—whether or not this counts as a 'disposal' of state property to be codified in the LSP is a matter to be considered by Georgian lawyers and legislative draftsmen. In many other jurisdictions, this would not be considered as a privatization or disposal, but as an interim measure to bring a company to a financial state more conducive to ultimate sale. Our recommendation is, of course, subject to Georgian civil law providing sufficient legal foundation for such a course of action.

9. Disenfranchisement of rights of leaseholders.

Under Art.12(5)of the LSP, if a leaseholder of agricultural land fails to exercise his right to buy the leased land by the deadline specified in the law (1 May 2011), the land can be sold as if it was unleased land. Art. 12(6) goes onto provide the state with the right to amend or terminate a lease of agricultural land in accordance with the rule prescribed under Georgian legislation (which is not specified). We understand that this right of lease amendment or termination complements the preceding power under Art. 12(5), allowing the state body to privatize the land unencumbered by the lease, otherwise the land would have to be sold still subject to the lease (thereby, potentially reducing its value).

Unless permitted under the terms of the lease contract, unilateral termination by one party (the state) can be termed a violation or material infringement of contract and property rights, even in the circumstances where it is carried out under a statutory power as in the LSP. According to international best practice, such an infringement can only be justified when (i) exercised for public use or otherwise in the public

interest and (ii) where the person subject to the act is paid appropriate compensation (in this case, perhaps offering alternative land for lease). Art. 12 does not refer to compensation or any other form of redress for the termination of a lease (although of course the lease itself may provide for these circumstances).

There are alternatives to lease termination—if the lease of the land has only a short period left to run, the land could be privatized subject to the lease remaining in place, as this would not affect the value of the land to such an extent as if the lease had a 20 years unexpired term, for example.

While not amounting to expropriation of property and therefore impermissible under the Constitution, we believe that this provision is still contrary to well-established principles of certainty of contract and security of property rights and we suggest that the GoG considers this issue very carefully, since the application of these powers as laid down in the LSP, without ameliorating measures, may cause controversy and could even subject the GoG to legal claims from aggrieved citizens who feel their contractual, civil, or human rights have been violated. The LSP could be amended to incorporate suitable compensation provisions or alternative solutions.

#### 10. Oversight and scrutiny of disposals.

The LSP contains no provision for oversight and scrutiny of privatization transactions or disposals which are carried out under the law. In other countries, the privatization process is often subject to such oversight and scrutiny e.g., in Bulgaria, every direct sale had to be approved by Parliament, which was generally considered to be excessive scrutiny given the political motivations which could (and often did) severely delay, and in some cases altogether put a stop to, privatization transactions. A more acceptable method of oversight and scrutiny which accords more to international best practice, is for a state body such as the UK Audit Commission (which has a large amount of statutory independence from government interference) to be mandated to investigate and scrutinize certain transactions after they have occurred, especially where the a government has exercised discretionary powers.

It is important that the body chosen or established for the task has the skills and resources to carry out its functions effectively, efficiently, and without fear or favor. In Georgia, the CoC<sup>33</sup> did have specific examining powers under the Law on Privatization of State Property of 1997<sup>34</sup>, but the LSP omits any such role. Prior to the enactment of the LSP, the CoC did play a part in reviewing privatization transactions under its 1997 remit<sup>35</sup> - and while the Chamber of Control Act of 2009

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<sup>33</sup> The Chamber of Control, established in 1995, is the supreme audit institution of Georgia. Its ambit covers the legislative, judicial and executive branches, local government agencies, special state funds, the National Bank of Georgia and other institutions. However, it has been notoriously ineffective; there are still no common standards for carrying out audits in the public sector and the Chamber's human resources are weak. Current reforms aim at improving capacity to conduct financial audits in accordance with international standards, still a far cry from the performance audits required to unearth contract irregularities (U4 Country Case Study -Georgia, 2007)

<sup>34</sup> Art. 11(4) – CoC had power to examine the ~~e~~quality of the privatized state property documents”

<sup>35</sup> For example, see the CoC Report on Activities Carried out by the Chamber of Control of Georgia in 2005; [www.control.ge](http://www.control.ge). The Report highlighted a number of deficiencies in the registration, management and privatization of the state property and in particular the nonfulfillment of the commitments made by investors under sale-purchase agreements

does include privatization in the activities covered by the CoC,<sup>36</sup> there has been little recent evidence of the CoC being active in this area recently.

We suggest that more research and enquiry is made in order to clarify whether the CoC can become more active in this area and whether this would require the requisite training and support.

#### 11. Transparency.

Although we have highlighted the issue of transparency in some of the points dealt with above (e.g., Issues 1, 2, 3, 4), it is worth making the issue a standalone one in terms of the privatization process generally. Provided there are clear rules at the outset and electronic methods of disposal are preferred over others, then the use of auctions and public competitive tenders will provide a much higher level of transparency by the very nature of the process. It is in the area of direct sales and in the use of discretionary powers that much more needs to be done by the relevant state bodies to ensure public confidence in the openness and fairness of the privatization process.

We have made recommendations in this regard already, but as a general principle, any decision order, rule, or instruction made by the GoG, the PoG, or the state seller of property in relation to a privatization or disposal should be made public by announcement or press release, posting on the relevant Web site and in certain important cases, in selected national newspapers. Wherever there are no genuine national interests or commercial confidentiality issues involved, we recommend that the full facts and details of any such decision, order, rule, or instruction, including reasons and justifications, should be made public by one or all of the means described, in accordance with current Georgian law as discussed above.

At the closure of each stage of a direct sale process, for example, information should be published so that the public are kept aware of progress. Georgia has adopted a Freedom of Information Charter (Chapter 3 of the General Administrative Code of 1999) and there is no reason in principle why it should not extend this type of openness to ongoing transactions of public interest<sup>37</sup>.

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<sup>36</sup> Under Art.6(2)(h), the CoC has the responsibility to examine the “management and disposal of the state, autonomous republic and municipal property”

<sup>37</sup> Complaints about this issue have consistently been made by many opposition groups, independent lobby groups and other respected organizations such as Transparency International, GYLA etc.

# C. RECOMMENDATIONS

## RECOMMENDATIONS FOR STEPS TO IMPROVE THE PRIVATIZATION PROCESS

### WORLD LEARNING/FORECAST REPORT

We have reviewed a copy of the World Learning/FORECAST Stage 2 Final Report for the MoESD on the Adoption and Implementation of an E-Government Program, which has as its core the objective for the MoESD to *“increase quality of service and interaction between the MoESD and its clients, particularly within its privatization and state assets management policy, propose and formulate concept, detailed description and action plan for development and expansion of electronic resources”*.

The scope of the FORECAST assignment was to develop the detailed concept for a comprehensive e-based SPMIS, as well as the User Process Functional Requirements, Preliminary System Design, and Technical Requirements.

We agree with the overall objective of this report and also with many of the recommendations of the report in relation to process, which we do not propose to repeat here. However, we do have some further recommendations to add to those included in the report, which are set out below.

### Key Findings

FORECAST identified some key problems with the current process, which cause delays, errors, and even loss of data during the process. FORECAST’s observations included the following:

- As a largely report-based system, the *“process of state property management and privatization cycle is somehow chaotic and needs restructuring”*
- There are significant *“organizational gaps”* in the process, e.g., multiplicity departments and divisions at MoESD and externally, leading to confusion and sometimes duplication of responsibilities<sup>38</sup>
- There are also *“functional gaps”*, such as the lack of process flows and checklists in the preparation of a privatization transaction

The SPMIS would not by itself cure all of the identified issues, but an all-electronic information system would have huge potential benefits for the MoESD in terms of efficiency, transparency, investor information access, and therefore outcomes.

The following minimum outputs are expected to be provided on the initial stage of development of the SPMIS (Section 3.5):

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<sup>38</sup> A list of many of the government ministries and their departments, agencies and other bodies with involvement in state property management and disposal is contained in Annexe 2 to this Report

- Creation of a unified state property database (including state enterprises and licenses)
- Processes of at least two structural units (DoSPMP, Privatization Department) to be fully automated
- Overlapping processes (state property registration, monitoring) to be automated and ready to be integrated in any modules
- Automated web-publishing and electronic data exchange with external data providers and consumers
- Fully functional web portal providing both public and private functionalities.

FORECAST also proposes a restructuring of operations and workflow process as follows:

- Front Office—a service which would be client facing, responsible for communication with clients both in Tbilisi and the regions, and would serve the middle office
- Middle Office, which would divide into two organizational units—the EMA and the Privatization Department, which would each have their current responsibilities, except that the Privatization Department would additionally be responsible for property leasing
- Back Office, where the Legal Department will reside and which will be responsible for the unified process in the cycle—state property registration, checking and management, and as well as responsibility for transfer of state property to governmental organizations and for all property-related external operations—registration of property, transferring, status checking, etc.

## SUMMARY OF ALL RECOMMENDATIONS FOR PRIVATIZATION PROCESS

Some of the following recommendations have been proposed in the body of this report and in the review of the LSP and its secondary legislation<sup>39</sup>. These recommendations are directly related to the privatization process and how it can be improved from the policy and operational viewpoint:

- Greater control and accountability of third parties involved in the privatization process (Issue 1)
- Introduction of competitive tender bidding rules for significant and/or valuable assets (Issue 3)
- Limitation on use of investment obligations to cases where these are fully justified (Issue 5)
- Up-front cash sales with no conditions to be used as widely as possible (Issue 5)
- Disapplication of auction method to sales of shares in state-owned companies (Issue 6)
- Simplification of granting of management rights in state-owned companies (Issue 7)
- Independent oversight and scrutiny of privatization transactions (Issue 9)

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<sup>39</sup> Pages 27-38 above

Further suggestions for improvement of the privatization process have come from meetings with interested parties during the course of the project, observations, and suggestions from public and private bodies which have experience of the privatization process. Other suggestions also arise from our review of the FORECAST Report. The principal recommendations are as follows:

1. Asset inventORIZATION. It is clear that a major obstacle to the rapid disposal of remaining state-owned property (in particular immovable property) is the lack of a complete inventory of assets. The government does not have clear information about all of the assets it owns and in many cases its immovable property is not registered or the registration details are not correct. The collection of data from variety of different sources, the identification of state properties, the defining of boundaries, and the recording of the data in written form is a necessary precondition to electronic recording of such information as part of the automated SPMS being proposed. This project is a long-term one - a pilot project for collection, identification, measuring, and recording of data on state property should be carried out in one district, but resources need to be found for a more comprehensive inventORIZATION.
2. Preregistration check on prior land ownership claims. Deputy Minister, Chelidze, mentioned a growing problem with some land sales. Prior to the registration procedures introduced by the NAPR in recent years, there was no compulsory national land registration and many landowners (e.g., those with certificates from previous privatization programs) have not subsequently registered their titles with NAPR. When the MoESD identifies an unregistered piece of land, it is entitled to claim it by default as state owned, register it and sell it at auction. In an increasing number of cases, an existing owner with an unregistered title comes forward and takes the new owner (and potentially the MoESD) to court, which results in the prior claim being upheld in some cases. We have recommended elsewhere that all currently unregistered ownership titles should be registered, but in the absence of this as a long-term solution, the MoESD should be required, as part of its analysis and preparation of land for sale, to carry out a prior ownership claim check, perhaps through the relevant LGSU or the APLR, which has documentation of many such unregistered ownership claims.
3. Fast-track liquidation procedures for certain state enterprises. For companies 100% owned by the state that are no longer operational and where the state is the principal creditor (e.g., holder of >90% of debts), the lengthy liquidation procedures under the Law on Bankruptcy Proceedings of 1996 (as amended) could be streamlined so that it is much easier to liquidate these companies. This could be achieved by instigating under the LSP a fast-track one-certificate process, whereby the MoESD, after consulting with all creditors, executes a liquidation certificate or order, which contains a guarantee to sell any remaining assets of the company and provide payment of debts according to the priority ranking in the Law on Bankruptcy Proceedings. The company would be struck off the register as soon as the assets were sold or transferred out of the company to be sold in future. This same procedure could be applied to so-called paper companies in which the state has all of the shares, but the company has no value and no assets.
4. Adjacent plots to be sold directly to neighbor/user. Where a plot of land which is owned by the state is used exclusively by a private citizen for access or which is surrounded by the land of such a private owner, that person should have a pre-emptive right to acquire the land without the need to go to auction. This only should

apply where there is no other person with any interest in or need of use of the land. This is an appropriate use of direct sales but only at a predefined value.

5. Improve corporate governance of state-owned companies. Under the LSP, all ownership rights in shares of new or existing state-owned companies are transferred to the EMA which has the functions outlined in the Section on State Enterprises (page 20 above). Ideally, the state should sell its shares in those companies as fast as possible, either by:
  - Offering equity to the other shareholders, where the state's shares comprise a minority stake, at an independently valued price<sup>40</sup>.
  - In appropriate cases (i.e., profitable companies), offering some or all of the shares to the public in an IPO as a step towards fully functioning capital markets<sup>41</sup>.

If the state cannot sell its shares in a company for any reason, the EMA should be mandated to take all possible steps to improve the company's performance so as to increase the value of the company. Operational state-owned companies are often poorly managed and only method currently employed by the EMA to improve their corporate governance is through contracts signed by the directors of each enterprise with the EMA. These contracts focus on compliance with the law, rather than on key governance issues, such as fiduciary duties, conflicts of interest etc. We recommend that the EMA prepare (with EPI assistance) a corporate governance manual or handbook, which directors would be contractually obliged to comply with.

6. Conditional payments for state property. Under the LSP, a buyer of certain types of state property (e.g., leased agricultural land under Art.13) has the right to pay by installments, sometimes up to two years, before he can acquire full ownership of the property under the sales contract. When each installment is paid, under Art.3(A)(5) of the LSP the state seller must *within 5 working days issue the written confirmation of full or partial compliance with the obligation, serving as the grounds for extinguishing the obligation or registering the amendment thereto with the [NAPR]*. The buyer then has the responsibility to register the certifying documents with the NAPR. The FORECAST Report recommends that the state seller should be responsible for registering the payment, not the buyer. While we have recommended elsewhere in this report that the installment basis of payment should be used as sparingly as possible, the better alternative to this cumbersome and bureaucratic procedure is for an electronic payment system to be used, as part of the SPMIS program, whereby MoESD and NAPR systems can be linked and integrated.
7. Electronic database of contracts with automated monitoring of investment conditions. Deputy Minister, Chelidze, informed us of an issue she has with the monitoring of around 1200 existing privatization sales contracts which contain investment conditions of varying kinds. At present, there is a very inefficient system for contract storage, recording of investment conditions and, therefore, monitoring fulfillment as these conditions fall due. Some of these contracts contain multimillion dollar

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<sup>40</sup> See Issue 4 in relation to the LSP on p.32

<sup>41</sup> See discussion of this option on p.32

obligations and in many cases are going without enforcement, thereby losing the GoG significant sums in terms of penalties under contract. The Deputy Minister urgently needs an automated system, whereby all existing and future contract conditions are recorded electronically and deadline dates and alerts for payments and investments to be made are notified electronically to the relevant person at the MoESD before they fall due, so that action is taken in timely fashion across all the contracts.

8. Creation of standard e-documents such as auction contracts and other sales contracts. Another problem facing Deputy Minister, Chelidze, is that the signing of contracts for any kind of privatization sale (but especially for auctions) is still done by hand in that each contract has to be processed individually, then printed out and taken to the person with sign-off powers for signature (Legal Department and the Minister), after which it must be notarized. According to the Deputy Minister, this procedure used to take three months, but after changes were introduced by her, the time is now reduced to a maximum of one month, whereas an all electronic e-document process (i.e., a standard form which can be filled in online and made accessible to other officials online) would take a few days maximum. Notarization of contracts can in theory also be integrated into this online system. This requirement is part of the FORECAST SPMIS automation proposal, but according to the Deputy Minister is urgently needed to speed up the privatization process.

## D. ADDITIONAL INFORMATION

### LIST OF INTERVIEWEES AND PERSONS MET

David Giorgadze, Deputy Minister	MoESD
Tamar Chelidze, Deputy Minister	MoESD
Giorgi Khodeli, Head of Privatization Department	MoESD
Vazha Chophikashvili, Deputy Head of Privatization Department	MoESD
Alexander Khojevanishvili, Chairman	EMA
Tamar Chugoshvili, Chairwoman	GYLA
Grant Morrill, OEG	USAID
Revaz Beridze and Mikheil Sulakvelidze	Eristavi Law Group
Aleksei Aleksishvili and Zaza Broladze	PMCG
Steve Wade, CoP	EPI
Vincent Morabito and Alex Bardzik, Agricultural Advisors	EPI
Dennis Zeedyk, Agriculture Component Leader	EPI
Chris Thompson and Nato Beruashvili BEE Component Leader/Deputy Leader	EPI
Malkhaz Nikolashvili, ICT Crosscutting Mgr	EPI

# LAW ON STATE PROPERTY OF 2010

## Law of Georgia on State Property

### Chapter I. General Provisions

#### Article 1. Scope of application of the Law

1. This Law shall regulate the relations pertaining to the management, the disposal of and the transfer with the right of use of the State property of Georgia.

2. Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

3. Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

4. Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

5. This Law shall not apply to:

a) the cases provided for under Article 10<sup>1</sup>.3.e of the Law of Georgia on State Procurement;

b) the alienation or any other type of disposal of the serviceable parts and material obtained as a result of reconstruction, refurbishment, dismantling or liquidation of the state-owned buildings transferred with the right of use to the bodies of the Georgian state authority, of autonomous republic of Abkhazia, of autonomous republic of Achara and of local self-governing unit or legal entity of public law for the purposes of fully or partially covering the expenses of reconstruction, refurbishment, dismantling or liquidation of these buildings by this authority or by the legal entity of public law. The serviceable parts and material obtained as a result of reconstruction, refurbishment, dismantling or liquidation of the state-owned buildings transferred for use to the bodies of the Georgian state authority, of autonomous republic of Abkhazia, of autonomous republic of Achara and of local self-governing units or legal entity of public law for the purposes of fully or partially covering the expenses of reconstruction, refurbishment, dismantling or liquidation of these buildings by this authority or by the legal entity of public law shall be alienated or otherwise disposed of in compliance with the rule and terms and conditions as prescribed by the Government of Georgia.

c) the cases as provided for under the Law of Georgia “on Acknowledgement of the ownership right on the land parcels possessed (Owned) by natural persons and by legal entities of private law”; *(10.12.2010 N 3963 effective as of January 1, 2011)*

d) the cases provided for under the Law of Georgia on “the Relations Arising from the Use of Dwelling”; *(10.12.2010 N 3963 effective as of January 1, 2011)*

e) the cases provided for under the Ordinance N73, dated January 29, 2007 of the President of Georgia “on the approval of the rule how the executive bodies of local self-governing unit should transfer for free use to the legitimate users the nonprivatized residential and nonresidential (isolated and nonisolated) space to be transferred to legitimate users, and Ordinance N219, dated April 30, 2007 of the President of Georgia “on the approval of the Rule

how to transfer the state-owned residential and nonresidential space accounted for in the balance sheet of the Ministry of Defense of Georgia; *(10.12.2010 N 3963 effective as of January 1, 2011)*

f) the protected areas, except for the protected landscape and multiple use areas as provided for under Article 4.1.b.b.e of this Law, the state forest reserves except for former kolkhoz and sovkhoz forests located within the territorial boundaries of settlements under Article 5.1.e of the same Law, Article 29<sup>1</sup> and 361<sup>1</sup> of this Law; *(10.12.2010 N 3963 effective as of January 1, 2011)*

g) the goods procured for natural persons within healthcare and social protection programs, as well as the distribution-issuance of disposable, high-wear goods, pharmaceuticals and food stuff (except for the property placed or to be placed under state ownership); *(10.12.2010 N 3963 effective as of January 1, 2011)*

h) sending-delivering of property to render humanitarian aid to other country's state authority, as well as the transfer of property in the form of a present or reward. *(10.12.2010 N 3963 effective as of January 1, 2011)*

## Article 2. Definitions used in this Law

The definitions used in this Law shall have the following meanings:

a) State property – state-owned movable and immovable items, intangible benefits of property;

b) Disposal of state property – privatization of state property, transfer of the right to manage, sale, distribute and destroy in accordance with the rule prescribed under the Georgian legislation;

c) Privatization – in accordance with the rule prescribed under this law acquisition of the ownership right on state property by natural persons or legal entities or their unions in the forms of electronic and/or public auction, direct sale, direct sale using competitive selection method and free of charge transfer

d) transfer with the right of use of the state property – transfer of the state property with the right of use in compliance with the Georgian legislation;

e) transferor with the right of use of the state property – the Ministry of Economy and Sustainable Development of Georgia (hereinafter the Ministry) or other authorized body as prescribed under this law who on behalf of the state transfers the state property with the right of use;

f) transfer with the right to manage – transfer of the state-owned shares and (hereinafter the shares and stock) with the right to manage to natural person or legal entity or other entity; *(10.12.2010 N 3963 effective as of January 1, 2011)*

g) property placed under state ownership – property placed under state ownership in the course of criminal civil and administrative proceedings of Georgia, property placed under (transferred in-kind) state ownership in accordance with the Laws of Georgia on Enforcement Proceedings and on Bankruptcy Proceedings, property placed under (transferred to) state ownership in accordance with the Tax Code of Georgia, property, subject to sale, transferred to

state ownership through inheritance and donation, un-owned and heirless property transferred to state ownership, goods not returned after performing test purchase under the Tax Code of Georgia; *(10.12.2010 N 3963 effective as of January 2, 2011)*

h) distribution of the movable property placed under state ownership – in accordance with the rule prescribed under the Georgian legislation, free of charge transfer of the movable property, placed under state ownership, by the Service Agency of the Ministry of Finance of Georgia (hereinafter the Agency) – the legal entity of public law falling under the governance of the Ministry of Finance of Georgia;

i) destruction of the movable property placed under the state ownership – destruction of the movable property, placed under state ownership, by the Agency in accordance with the rule prescribed under the Georgian legislation;

j) third party (chargé d'affaires, broker) – natural person or legal entity or union of entities seeking the persons who wish to privatize the state property and, by initiating the privatization, supporting the process of privatization of the state-owned immovable property and performing his/her duty on the basis of the contract signed with the Ministry; *(10.12.2010 N 3963 effective as of January 1, 2011)*

k) sale of the movable property placed under state ownership – selling of the movable property, placed under state ownership, by the Agency through auction, direct sale or third party;

l) shares and stock – shares and stock registered in the state's name with the competent registering authority;

m) initial transfer with the right of use – transfer with the right of use of the state property nontransferred with the right of use to the bodies of the Georgian state authority, of autonomous republic of Abkhazia, of autonomous republic of Achara and of local self-governing units, natural persons and legal entities by the Ministry;

n) privatization plan – the aggregate of information about the cadastral technical drawing of the forest existing within territorial boundaries of the settlement, cadastral information, space, location and land price calculated based thereabove; *(10.12.2010 N 3963 effective as of January 1, 2011)*

o) household ledger – the journal illustrating the information on the number of households and of their members within territorial boundaries of the settlement (village, township, town), union of settlements (community) certifying the fact that they reside in this particular settlement and that they are the member of the household;

p) state-owned un-leased agricultural land – agricultural land owned by the state which had not been leased as of January 25, 2005;

q) state-owned leased agricultural land – agricultural land owned by the state to which lease agreement applied;

r) privatization of the forest existing within the territorial boundaries of the settlement – privatization subject to payment of the former kolkhoz and sovkhos forest lands with or without the forests attached thereon;

s) Removed (*10.12.2010 N 3963 effective as of January 1, 2011*)

t) immovable item – immovable property owned by the state, agricultural land, forest existing within the territorial boundaries of the settlement, protected landscape, multiple use area;

t<sup>1</sup>) immovable property – state-owned nonagricultural land with attached buildings (under construction, already built or demolished) or without it, building block (under construction, already built or demolished), linear object, multiyear plantations growing on the land; (*10.12.2010 N 3963 effective as of January 1, 2011*)

t<sup>2</sup>) agricultural land – agricultural land used for production of the plant growing and animal husbandry (poultry, fishery) products with or without multiyear plantations and/or buildings growing thereon; (*10.12.2010 N 3963 effective as of January 1, 2011*)

u) unconditional and irrevocable bank guarantee – unconditional and irrevocable bank guarantee to be submitted for disposing of the state property; (*10.12.2010 N 3963 effective as of January 1, 2011*)

v) upfront – as a security for compliance, the amount of money to be paid to the account specified by the entity otherwise carrying out the auction or privatization; freeze of the amount of money available at participant's bank account shall be treated as the payment of upfront, which will be transferred to the entity carrying out the auction as soon as the participant wins the auction or violates the rule and terms and conditions laid down under this law;

w) application – expression of interest to participate in the auction by the person seeking to participate in the auction, thus certifying that applicant has read and agreed to the rule and terms and conditions of the action. The application shall also contain the information on the participant of the auction, name of the state property, initial privatization price and other information; (*10.12.2010 N 3963 effective as of January 1, 2011*)

x) privatization revenue – amount of money received from privatization of the state property to be paid to the state budgets, the autonomous budgets of the autonomous republics of Abkhazia and Achara and/or the budget of local self-governing units; (*10.12.2010 N 3963 effective as of January 1, 2011*)

y) privatization price – amount of money to be paid by the buyer of state property including privatization revenue and the amount to be paid to the third party or other entity if privatization terms and conditions provide so. (*10.12.2010 N 3963 effective as of January 1, 2011*)

### Article 3. Buyer of the state property

1. Buyer of the state property (except for the cases of privatization/sale of the state-owned agricultural land parcel and of distribution of the movable property placed under state ownership) may be a citizen of Georgia or a foreign country or legal entity of private law or union of entities and the share of the Georgian state authority or self-governing unit in the property of such buyer shall be less than 25%.

2. State-owned agricultural land parcel may be privatized subject to payment by a citizen of Georgia or legal entity of private law registered in Georgia, and by the Georgian Apostolic Autocephaly Orthodox Church and citizens of Georgia left homeless who used to live or are living on the occupied territories -for free of charge.

3. Based on the special decision of the President of Georgia, the rule and terms and conditions of free of charge transfer of the state-owned un-leased agricultural land parcel to the citizens of Georgia left homeless who used to live or are living on the occupied territories shall be laid down under the Ordinance of the President of Georgia. To have a special decision of the President of Georgia adopted, the Ministry shall be responsible to prepare the issue and submit to the President.

4. Removed (*10.12.2010 N 3963 effective as of January 1, 2011*)

5. Based on the consent of the Government of Georgia, the Ministry shall transfer the state property in the ownership of natural persons and/or legal entities of private law in reciprocal transfer of the state property equal to that property. The rule and terms and conditions of such transfer shall be laid down under the Order of the Ministry of Economy and Sustainable development.

Article 3<sup>1</sup>. The Rule on the Conduction of Transaction in Privatization of the State-owned Immovable item (*10.12.2010 N 3963 effective as of January 1, 2011*)

1. In privatization of the state-owned immovable item, sales contract shall be signed between the authority carrying out the privatization and the buyer, serving as the grounds for registration of the ownership right with the Public Registry and for commencement of the relevant obligation (including payment of privatization price).

2. In privatization of the state-owned immovable item via auction, the forms of sales contract shall be approved by the Ministry. The authority carrying out the privatization shall have the right to issue confirmation on winning the auction.

3. In privatization via auction the sales contract shall be signed within one month after conduction of the auction, in privatization by using direct sale by the President of Georgia – within three months after publication of the relevant act, and in privatization via direct sale by the Ministry, its territorial unit, or competent body of the executive authority of the autonomous republics of Abkhazia and Achara operating within the competence delegated by the Ministry – within one month after publication of the relevant act.

4. The buyer shall be liable to ensure payment of privatization price within the set deadline which shall not be less than seven calendar days and not more than two calendar years and, within the same time period, submit the document certifying the payment of privatization price to the authority carrying out the privatization.

5. In the event where the obligation has commenced and the document certifying the compliance with the obligation is submitted, the authority carrying out the privatization shall, within 5 working days, issue the written confirmation of full or partial compliance with the obligation, serving as the grounds for extinguishment of the obligation or registering the amendment thereto with the Public Registry.

6. In the event where investment conditions exist and upon the Ministry's consent the buyer shall have the right to encumber with mortgage the purchased immovable item as a security for compliance with privatization obligation.

7. In the event where investment conditions are not present the buyer shall have the right to encumber with mortgage the purchased immovable thing as a security for compliance with the privatization obligation.

#### Article 4. The State Property not Subject to Privatization

1. The following state property shall not be subjected to privatization:

- a) the interior of the earth;
- b) water resources;
- c) territorial waters;
- d) continental shelf;
- e) state forest reserves, except for the former kolkhoz and sovkhoz forests existing within the territorial boundaries of the settlements; *(10.12.2010 N 3963 effective as of January 1, 2011)*
- f) air space;
- g) strict nature reserve;
- h) national park;
- i) natural monument;
- j) managed nature reserve
- j<sup>1</sup>) recreation zones and/or special construction regulation zones as prescribed by the President of Georgia; *(10.12.2010 N 3963 effective as of January 1, 2011)*
- k) duly approved sites of historical-cultural and artistic values, buildings having cultural and art function as well as land parcels with these sites attached thereon without conditions and without agreeing with the Ministry of Culture and Monument Protection;
- l) buildings of religious and worshiping functions (operating and nonoperating), their ruins, as well as land parcels with the said attached thereon;
- m) state historical and cultural archives of special significance;
- n) state cinema reserves, photo reserves and phono-documents reserves of special significance;
- o) archives and reserves of special significance of the Georgian Ministries (departments) and scientific-research institutions;
- p) museum collections and reserves of special significance;

- q) house museums of special significance;
- r) the property used for dispatching in electric energy sector;
- s) property in use by legal entities of public law with the public schools, high educational and scientific institutions of Georgia operating therein;
- t) sea port berths, hydro technical facilities, lighthouses, beacons and water space;
- u) motor roads (in the case of unavailability of alternative road);
- v) air traffic, management and control tools;
- w) flight runways of special significance;
- x) frequency spectrum;
- y) Georgia's position on the geostationary orbit;
- z) state pantheons;

a.a) property transferred for accommodation of the Prosecutor's Office of Georgia, Ministries of Defense and Internal Affairs of Georgia in accordance with the rule prescribed under the Georgian legislation;

b.b) the following kinds of state-owned agricultural land:

b.b.a) pastures except for the pastures leased before July 30, 2005 and except for the pastures that are attached to the buildings thereon which are privately owned by the natural persons and/or legal entities and/or are state-owned, in accordance with the duly issued document by the state or self-governing (government) unit authority;

b.b.b) livestock droving routes;

b.b.c) top layer sanitation zone of water supply sites (controlled access area);

b.b.d) land intended for the monuments of history, of culture, of nature and of worship and religion;

b.b.e) land of protected areas, except for protected landscape and multiple use areas; *(10.12.2010 N 3963 effective as of January 1, 2011)*

b.b.f) agricultural lands used by usufruct by the state-budget-funded institutions and legal entities of public law;

b.b.g) land parcels adjacent to the Georgian rivers – Enguri, Rioni, Kvirila, Mtkvari, Khrami, Tergi, Ksani, Aragvi, Sufsa, Bakhvistskali, Khobi (Khobistskali), Tekhura, Tskhenistskali, Dzirula, Nenskri, Kintrishi, Jejori, Khanistskali, Gubazeuli, Paravani, Stori, Nakri, Kheleduli, Jonouli, Sakauri, Chakvistskali, Tsablarastskhali, Samkuristskali, Magani, Pirikiti Alazani, Avanskhevi, Dumali, Chelti, Chveshuri (Chashuri), Duruji, Chkhorotsku, Ivri, Lebarde, Tsachkhuri, Bjoliskhevi, Chanistskali, Merisi (Akavreti), Shavitsklis, Uraveli, Khumfreri,

Kvirilistskali, Jutistskali, Chorokhi and Acharistskali, on which construction of renewable energy sources are foreseen and X and Y coordinates of which are approved under the Order of the Minister of Economy and Sustainable Development.

2. Agricultural lands under subparagraphs „b.b.b“–„b.b.d“ and „b.b.g“ of paragraph 1 of this Article may be privatized only in the case of implementation of important projects on which the Government of Georgia shall adopt special decision based on the Ministry’s recommendation. In addition, the land under subparagraph „b.b.c“ of paragraph 1 of this Article may be privatized only in consideration of sanitation code.

3. Agricultural lands under subparagraphs „b.b.b“ and „b.b.d“ of paragraph 1 of this Article may be privatized also to the citizens of Georgia left homeless who lived or are living on the occupied territories.

4. The property existing within the recreational zones and/or special construction regulation zones as prescribed by the President of Georgia may be privatized only upon the decision of the Government of Georgia. The Government of Georgia shall have the right to delegate this authority for a definite period of time to other administrative authority or self-governing unit. *(8.04.2011 N 4519)*

5. Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

6. The list of the state property of special importance shall be approved by the Government of Georgia.

Article 5. Information on the privatization and sale of the state property by using the auction method

1. The information on the privatization of the state property by using the public auction method shall be published on the Web site of the entity disposing of the state property and/or on [www.eauction.ge](http://www.eauction.ge) Web site, to be deemed as official publication of the information. In order to ensure publicity and access to the information, the information on the privatization of the state property by using the public auction method shall be also published in the newspaper “24 Hours”. *(10.12.2010 N 3963 effective as of January 1, 2011)*

2. The information on conduction of the public action in privatization of the former kolkhoz and sovkhoz forests existing within the territorial boundaries of the settlements shall be published in the press and posted up in the building of the competent local representative body (Sakrebulo).

3. The deadline for publication of the information on the privatization of the state property by using the auction method shall be set by the Ministry. *(10.12.2010 N 3963 effective as of January 1, 2011)*

4. Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

5. Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

6. Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

7. Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

8. Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

Article 5<sup>1</sup>. Integrated Management Tools *(10.12.2010 N 3963 effective as of January 1, 2011)*

1. For the sake of document flow and access to information the Ministry shall make use of software and integrated management tools.

2. The Ministry shall be entitled to adopt, publish or issue any information and/or document by using the Integrated Management Tools.

3. The Ministry shall be entitled to save and issue any document created thereby or stored therewith in the form of an electronic copy.

4. The electronic copy and print out of the document under Paragraph 3 of this Article shall be as legally valid as this document.

5. In the documents published or issued by the Ministry the data shall be entered manually and/or electronically.

Article 6. Precondition for participation in the auction

1. The objective of the disposal of the state property via auction is to grant the right of ownership/of use to the participant of the auction who during auction bids the highest price to the entity disposing of the state property and if the auction is announced with conditions – to grant the right of ownership/of use to the participant of the auction who assumes the obligation of meeting the announced terms and conditions and during auction bids highest price to the entity disposing of the state property.

2. The state property may be disposed of via electronic auction. If state-owned property fails to be sold/transferred for use, it may be disposed of via public auction. The regulation on the disposal of the state-owned property via public auction shall be approved by the Minister of Economy and Sustainable Development.

3. Person interested to participate in the auction shall present the unconditional and irrevocable bank guarantee/the upfront. The amount of the unconditional and irrevocable bank guarantee/the upfront shall be set by the authority carrying out the privatization on case-by-case basis. *(10.12.2010 N 3963 effective as of January 1, 2011)*

4. The results of the auction shall be abolished if:

a) the winner of the auction fails to present the document certifying the payment of the price within the deadline laid down under this Law;

b) the winner of the auction refuses to sign the sales contract. *(10.12.2010 N 3963 effective as of January 1, 2011)*

5. In cases under paragraph 4 of this Article, the amount of unconditional and irrevocable bank guarantee/the upfront presented by the winner of the auction shall be fully transferred to the relevant budget.

6. Except for the case under paragraph 5 of this Article, the amount of unconditional and irrevocable bank guarantee/the upfront shall be fully transferred to the relevant budget, if the participant of the auction violates the rule and/or terms and conditions of participation in the auction prescribed under the normative act.

7. If the state authority/legal entity of public law postpones the action or abolishes the decision “on the disposal of the state property via auction” before conducting this auction, the participant shall be refunded the paid upfront.

8. In the case of failure to dispose of the auctioned state property, the decision on the disposal of the state property via auction with reduced initial price and/or conditions of this state property shall be deemed as repeated auction. may be deemed as repeated auction.. Initial price of the repeatedly auctioned state property may be reduced up to 50% and if the state-owned property fails to be sold even after offering this reduced price, the price may be further reduced.

9. In the case of failure to dispose of the auctioned state property, the entity disposing of the state property shall have the right to take decision on the disposal of the state property via extended auction under the same terms and conditions.

10. Paragraph 2 of this Article shall not apply to Chapter III of this Law.

11. Paragraph 3 of this Article shall not apply to Chapter V of this Law. When selling the movable items placed under the state ownership by the Agency, the rule and terms and conditions of the submission of bank guarantee/upfront shall be laid down under the Order of the Minister of Finance of Georgia.

Article 6<sup>1</sup>. Reimbursement of the Third Party’s Service *(10.12.2010 N 3963 effective as of January 1, 2011)*

Service rendered by third party shall be reimbursed out of privatization price based on the contract signed between the Ministry and the third party.

## Chapter II. The State-owned Agricultural Land

Article 7. The Methods of Privatization of the state-owned agricultural land and the authorities carrying out the privatization

1. The following shall be the methods of privatization of the state-owned agricultural land: *(10.12.2010 N 3963 effective as of January 1, 2011)*

a) auction;

b) direct sale:

b.a) direct sale based on the decision of the President of Georgia;

- b.b) direct sale via competitive selection based on the decision of the President of Georgia;
- b.c) direct sale of the leased land.

2. Privatization via auction of the state-owned un-leased agricultural land parcel shall be carried out by the Ministry, its territorial unit or competent body of the executive authority of the autonomous republics of Abkhazia and Achara operating within the competence delegated by the Ministry.

3. Privatization via direct sale and via direct sale through competitive selection of the state-owned un-leased agricultural land parcel shall be carried out under the decision of the President of Georgia.

4. The Government of Georgia, based on prior consent of the Ministry of Internal Affairs of Georgia, in consideration of state and public interests, shall adopt special decision on the privatization of individual state-owned agricultural land parcels located within 500 meter border line as prescribed under the Law of Georgia on the State Border of Georgia. *(10.12.2010 N 3963 effective as of January 1, 2011)*

5. Privatization via direct sale of the state-owned un-leased agricultural land parcel shall be carried out by the Ministry, its territorial unit or competent body of the executive authority of the autonomous republics of Abkhazia and Achara operating within the competence delegated by the Ministry.

6. The Ministry shall be entitled to sign contracts with third parties who will ensure to initiate the privatization of the state-owned agricultural land and if necessary to make cadastral technical drawings. *(10.12.2010 N 3963 effective as of January 1, 2011)*

7. The third parties implementing the measures under paragraph 6 of this Article, will be reimbursed the amount, to be laid down under the relevant contract, of the privatization price earned from alienation of the state-owned un-leased agricultural land parcel. *(10.12.2010 N 3963 effective as of January 1, 2011)*

8. The rule and terms and conditions of the initiation by third parties of the privatization of state-owned agricultural lands shall be laid down under the Order of the Minister of Economy and Sustainable Development. *(10.12.2010 N 3963 effective as of January 1, 2011)*

Article 8. Initiation, layout and landmarking of the privatization via auction of the state-owned un-leased agricultural land parcels

1. Citizen of Georgia, legal entity of private law registered in Georgia, the Ministry and the third person shall have the right to initiate the privatization via auction of the state-owned un-leased agricultural land parcels.

2. If the citizen of Georgia, legal entity of private law registered in Georgia as well as third party initiates the privatization via auction of the state-owned un-leased agricultural land parcels, they shall address the Ministry, its territorial unit or competent body of the executive authority of the autonomous republics of Abkhazia and Achara operating within the competence delegated by the Ministry.

3. The Ministry or the initiator shall do the layout and landmarking of the state-owned un-leased agricultural land parcels. *(10.12.2010 N 3963 effective as of January 1, 2011)*

4. Where the citizen of Georgia, legal entity of private law registered in Georgia as well as third party seek to privatize via auction the state-owned un-leased agricultural land parcels, they shall: *(10.12.2010 N 3963 effective as of January 1, 2011)*

a) select the state-owned un-leased agricultural land parcel (parcels) and if necessary divide into optimal-size (at least 3 hectares) parcels. This restriction shall not apply if the area of the land parcel is less than 3 hectares;

b) make detailed cadastral technical drawing (drawings) of the selected state-owned un-leased agricultural land parcel (parcels), as well as obtain information on the category and quality of the land parcel (parcels);

c) submit to the authority carrying out the privatization the statement on expression of interest in the privatization via action of the state-owned un-leased agricultural land parcel

Article 9. The initial price of the auctioned state-owned un-leased agricultural land parcel and the rule of its payment *(10.12.2010 N 3963 effective as of January 1, 2011)*

1. The initial price of the auctioned state-owned un-leased agricultural land parcel shall be set by the Government of Georgia for administrative territorial units on an individual basis. The initial price of the auctioned state-owned un-leased agricultural land parcel may be reduced based on the decision of the Government of Georgia. If state-owned farm building (buildings) and facility (facilities) and/or multiyear plantations are attached to the state-owned un-leased agricultural land parcel, the auctioned state-owned un-leased agricultural land parcel shall be sold for the price of a land parcel, despite the state-owned farm building (buildings) and facility (facilities) and/or multiyear plantations attached thereon.

2. The winner of the auction shall within one month after conduction of the auction pay the price of the state-owned un-leased agricultural land and submit to the authority carrying out the privatization the document certifying this payment. The authority carrying out the privatization shall issue written confirmation on the full or partial compliance with the obligation serving as grounds for extinguishment of the obligation or registering the amendment thereto with the Public Registry.

Article 10. Privatization of the state-owned un-leased agricultural land parcel by using the direct sale and direct sale via competitive selection methods

1. The objective of the privatization via direct sale of the state property is to grant the right of ownership to the buyer who fully and in good faith meets the condition (conditions) laid down for privatization via direct sale of the state property, and where direct sale is made by using competitive selection – to grant the right of ownership to the interested person (potential investor) who fully and in good faith meets the condition (conditions) laid down for privatization via direct sale by using competitive selection of the state property.

2. The state-owned un-leased agricultural land parcel shall be directly sold and directly sold by using competitive selection upon the decision of the President of Georgia based on the recommendation of the Ministry and in special cases of the Government of Georgia.

3. The state-owned un-leased agricultural land parcel shall be directly sold by using competitive selection if:

- a) there are multitude of conditions of investment making;
- b) interested persons offer alternative conditions.

4. The procedures laid down under this Article for direct sale by using competitive selection of the state-owned un-leased agricultural land parcel shall commence upon expression of interest by the interested person.

5. The proposals made by the interested persons shall be reviewed by the Ministry and in special cases by the Government of Georgia, and shall take the decision on implementation of relevant measures for the purposes of direct sale by using competitive selection.

6. For the purposes of direct sale by using competitive selection method, the Ministry, and in special cases the Government of Georgia, shall publish the decision on the conditions of privatization of the state-owned un-leased agricultural land parcel in domestic and/or international media and shall set the deadline for expression of interests which as a rule may not be less than one month. If delay might cause damage to state and/or public interests, this deadline, based on the decision of the Government of Georgia, may be reasonably reduced on grounds of otherwise guaranteeing the publicity and informing the potential investors.

7. The Ministry, and in special cases the Government of Georgia, after exhaustion of the deadline for expression of interest, shall review the incoming applications and submit to the President of Georgia the well-grounded proposals on direct sale via competitive selection of the state-owned un-leased agricultural land parcel. The decision on direct sale of state-owned un-leased agricultural land parcel shall be made by the President of Georgia.

8. In case of direct sale using the competitive selection method and before the expiry of the period for the expression of interest, interested party shall present the unconditional and irrevocable bank guarantee or upfront for 5% of the price of the state-owned un-leased agricultural land parcel as a security for compliance with the conditions of privatization of the state-owned un-leased agricultural land parcel. Where the investment obligation exists in the conditions of privatization of state-owned leased agricultural land parcel, the bank guarantee under this paragraph shall be presented or the relevant amount of money shall be deposited as a security for assuming the obligation (signing the relevant contract) to comply with the conditions of privatization of the state-owned leased agricultural land parcel. If the amount of offered investment exceeds the value of the state-owned leased agricultural land, the said unconditional and irrevocable bank guarantee or the amount of money deposited shall amount to 5% of the offered investment amount. In the case of failure to meet the conditions, this amount shall be transferred to the state budget in the event of privatization of state property or to the budget of local self-governing unit in the event of privatization of the property of local self-governing unit. Where the investment obligation exists, after assuming the obligation on property privatization conditions (after signing the relevant contract) the deadline for submission, the amount and other conditions of unconditional and irrevocable bank guarantee/the upfront shall be laid down under Article 20 of this Law.

9. The President of Georgia shall be entitled to take the decision on direct sale via competitive selection of the state-owned un-leased agricultural land parcel without taking the measures under this Article.

10. In privatization of the state-owned un-leased agricultural land parcel via direct sale, based on the decision of the President of Georgia, and via direct sale by using competitive selection based on the Decision of the President of Georgia, the amount of land parcel and the rule of its payment shall be laid down under the relevant decision of the President of Georgia. *(10.12.2010 N 3963 effective as of January 1, 2011)*

11. The rule of direct sale of the state property by using competitive selection method under this Article shall not be applied to the state-owned immovable property transferred with the right of use to and/or accounted for in the balance sheet of the state authority/legal entity of public law.

Article 11. Declaration of the state-owned un-leased agricultural land parcels as the Property of the Georgian Apostolic Autocephaly Orthodox Church

As per Article 11 of the Constitutional Agreement signed between the State of Georgia and the Georgian Apostolic Autocephaly Orthodox Church:

a) agricultural land parcels in use of the Georgian Apostolic Autocephaly Orthodox Church shall be declared as the church property:

b) the Georgian Apostolic Autocephaly Orthodox Church shall have the right, in agreement with the Ministry, to accept the state-owned un-leased agricultural land parcels under its ownership free of charge.

Article 12. The Conditions of Privatization via Direct Sale of the State-owned Leased Agricultural Land Parcel

1. The state-owned leased agricultural land parcel shall be subjected to privatization via direct sale.

2. The necessary precondition for privatization via direct sale of the state-owned leased agricultural land parcel is the lease agreement signed between the state and the lessee and registered with the Public Registry.

3. The state owned leased agricultural land shall be privatized via direct sale on the basis of lease agreement, excerpt from the Public Registry and cadastral plan.

4. Privatization of the part of the state-owned leased agricultural land shall be prohibited. If the state-owned leased agricultural land space is comprised of several land parcels detached from each other in space / geographically independent, the lessee shall have the right to redemption of the state-owned leased agricultural land parcel (parcels) concerned. If the part of the state-owned leased agricultural land parcel is privatized, the lease agreement on the remaining state-owned leased land parcel (parcels) shall be cancelled and it (they) shall be sold in

accordance with the rule prescribed under this Law for privatization of the state-owned un-leased agricultural land.

5. If lessee fails to apply to the competent authority on privatization via direct sale of the state-owned leased agricultural land parcel, then upon expiry of the deadline set under paragraph 4 of Article 47 of this Law, the state-owned leased agricultural land parcel (parcels) shall be sold in accordance with the rule prescribed under this Law for privatization of the state-owned un-leased agricultural land. *(10.12.2010 N 3963 effective as of January 1, 2011)*

6. The Ministry, its territorial unit or competent body of the executive authority of the autonomous republics of Abkhazia and Achara operating within the competence delegated by the Ministry, shall have the right to change and/or amend as well as terminate and dissolve, in accordance with the rule prescribed under the Georgian legislation, the lease agreement on the state-owned leased agricultural land. Also the same entities shall be authorized to finalize the procedure of lease of state-owned agricultural land parcel. The competent body of local self-governing unit, within the framework of the competence delegated by the state authority, shall supervise payment of the rental fee as agreed under the lease agreement and supply information to the competent authorities.

7. The Ministry, its territorial unit or competent body of the executive authority of the autonomous republics of Abkhazia and Achara operating within the competence delegated by the Ministry, shall, within 10 days upon receipt of lessee's application, review the submitted documentation and where their accuracy is established, shall notify the lessee on payment of the relevant price and where the document certifying the payment of the price is presented, shall sign the sales contract with the buyer of the state property on the state-owned, leased agricultural land parcel and farm building and facility (facilities) and/or multiyear plantations attached thereon, in order to register the ownership right with the Public Registry, and where the price is to be paid in installments, shall sign the sales contract indicating the obligation to pay the remaining part of the price. *(10.12.2010 N 3963 effective as of January 1, 2011)*

Article 13. The Price of the State-owned Un-leased Agricultural Land Parcel and the Rule of its Payment *(10.12.2010 N 3963 effective as of January 1, 2011)*

1. The initial price of the state-owned leased agricultural land parcel privatized via direct sale shall be set by the Government of Georgia for administrative territorial units on an individual basis. The price of the state-owned leased agricultural land parcel may be reduced based on the decision of the Government of Georgia. If state-owned farm building (buildings) and facility (facilities) and/or multiyear plantations are attached to the land parcel, the state-owned agricultural land parcel and the state-owned farm building (buildings) and facility (facilities) and/or multiyear plantations attached thereon shall be sold for the price of the state-owned leased agricultural land parcel.

2. A lessee may pay the price of the state-owned leased agricultural land parcel fully or in installments during one year. In 50% of the price is to be paid, the sales contract shall be signed.

### Chapter III. Privatization of the Forest existing with the Territorial Boundaries of the Settlement

#### Article 14. Forests Subjected to Privatization

As per this Law, former kolkhoz and sovkhoz forests existing within the territorial boundaries of the settlements shall be subjected to privatization.

Article 15. Privatization via Public Auction of the Land Parcel part of the Forest Existing within the Territorial Boundaries of the Settlement

1. Land parcel being part of the forest existing within the territorial boundaries of the settlement shall be privatized via public auction. If public auction fails to reveal the winner, public auction shall be repeatedly conducted. Sales contract shall be signed between the authority carrying out privatization and the winner of the auction. *(10.12.2010 N 3963 effective as of January 1, 2011)*

2. A Georgian citizen or group of Georgian citizens (persons) registered as per the identity card and/or recorded in the household ledger within territorial boundaries of the particular administrative unit – settlement (village, township, town), union of settlement (community).

3. The precondition for privatization of the land parcel being part of the forest existing within the territorial boundaries of the settlement shall be:

- a) use of the forest land parcel according to its intended purpose;
- b) protection of unique samples existing on the forest land parcel, included in the Georgia's "Red List";
- c) nonrestriction on the use by other persons of the forest gift (berries and other tree fruits), nonhardwood resources and places of common use of water (river, gully, brook, spring etc.) existing on the forest land parcel and on hunting therein.

4. If the buyer alienates the land parcel, preemptive right belongs to Georgian citizens registered as per the identity card and/or recorded in the household ledger within territorial boundaries of the particular administrative unit – settlement (village, township, town), union of settlement (community).

Article 16. Duties of the Ministry and its territorial units in privatization of the forest existing within the territorial boundaries of the settlement

In privatization of the forest existing within the territorial boundaries of the settlement, the Ministry and its territorial units shall:

- a) approve the privatization plan. Privatization plan may be approved by splitting the land parcels to be privatized into lots;
- b) register with the competent registering authorities of the Public Registry the right of state ownership on the land parcel being part of the forest existing within the territorial boundaries of the settlement;

c) organize and conduct public auction, sign sales contract with the winner of the auction and upon receipt of the document certifying the payment of privatization price, confirm the payment of the privatization price. *(10.12.2010 N 3963 effective as of January 1, 2011)*

d) Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

Article 17. Initial price of the land parcel to be sold via public auction, being part of the forest existing within the territorial boundaries of the settlement and the rule of its payment

1. Initial price per hectare of the land parcel to be sold via public auction, being part of the forest existing within the territorial boundaries of the settlement shall be GEL 200.

2. Proceeds of privatization of the forest existing within the territorial boundaries of the settlement shall be transferred to the budget of competent local self-governing unit.

3. Within thirty calendar days after signing of the sales contract the winner of the public auction shall pay the price for the land parcel part of the forest existing within the territorial boundaries of the settlement and shall submit the document certifying the payment to the authority carrying out privatization. The authority carrying out privatization shall issue confirmation on fulfillment of the obligation serving as grounds for extinguishment of the obligation with the Public Registry. *(10.12.2010 N 3963 effective as of January 1, 2011)*

#### Chapter IV. The State-owned Immovable Property

Article 18. The Forms of Privatization of the State-owned Immovable Property and the Authorities Carrying out Privatization

1. The following shall be the forms of privatization of the state-owned immovable property:

- a) auction;
- b) direct sale;
- c) direct sale using competitive selection.

2. The Ministry / territorial unit of the Ministry shall carry out privatization via auction of the state-owned immovable property.

3. Privatization of the state-owned immovable property via direct sale and via direct sale using competitive selection shall be carried out on the basis of the decision of the President of Georgia, in compliance with the rule under Article 10 of this Law and its direct sale shall be carried out by the Ministry in accordance with the rule under Article 18<sup>1</sup> of this Law. *(10.12.2010 N 3963 effective as of January 1, 2011)*

4. The Ministry shall be entitled to sign contract with third parties who will ensure to initiate privatization of the state-owned immovable property and if necessary prepare cadastral technical drawings. *(10.12.2010 N 3963 effective as of January 1, 2011)*

Article 18<sup>1</sup>. Privatization of the state-owned leased immovable property via direct sale  
(10.12.2010 N 3963 effective as of January 1, 2011)

1. The Ministry shall be entitled to carry out privatization of the state-owned immovable property leased before January 1, 2007 via direct sale to the lessee. The price of the state-owned leased immovable property shall make up the fivefold amount of annual market value of its rental. The annual market value of property rental shall be determined by a certified evaluator of the office accredited by the Accreditation Centre – the Georgian Unified National Accreditation body.

2. The necessary precondition for privatization of the state-owned leased immovable property via direct sale is the lease agreement signed between the state and the lessee and registered with the Public Registry.

Article 19. The Rule on setting the privatization price of the state-owned immovable property and on its payment

1. The rule on setting the privatization price of the state-owned immovable property shall be approved by the President of Georgia. In setting the privatization price of the state-owned immovable property paragraph 6 of this Article shall be taken into account.

2. Price of the purchased state-owned immovable property may be paid in a lump sum or in installments.

3. The winner of the auction shall pay the privatization price of the state-owned immovable property within the deadline set by the authority carrying out privatization which shall be not less than seven days and not more than thirty calendar days. If auction is with conditions, the authority carrying out privatization shall set the deadline for payment of the privatization price which shall not be more than 2 years. (10.12.2010 N 3963 effective as of January 1, 2011)

4. In privatization of the state-owned immovable property via direct sale, the buyer shall pay the privatization price of the state-owned immovable property after signing the contract, within the deadline set by the President of Georgia which shall not be more than one year, except for the cases under paragraph 5 of this Article.

5. Where necessary, in order to avoid potential damage to the state or local self-governing unit or to avoid or/and to finalize judicial or arbitration proceedings, the President of Georgia shall be entitled to set for the payment of the privatization price of the state-owned immovable property longer deadline than set under paragraph 4 of this Article but not more than five years.

6. As per the rule of setting the normative price of nonagricultural land parcel by the President of Georgia, the representative body (Sakrebulo) of the competent self-governing unit shall set the normative price of the state-owned land parcel in consideration of the market value.

Article 20. Special conditions of privatization of the state-owned immovable property

1. If investment obligation is set as privatization condition on the state-owned immovable property, the buyer shall submit unconditional and irrevocable bank guarantee / the upfront in the amount of at least 10% of the investment obligation within one month after signing the relevant sales contract - in the case of privatization via direct sale, and in the case of auction - after drafting the report on winning the auction. The deadline for submission shall be at least two months longer than the deadline for fulfillment of the investment obligation. The amount of unconditional and irrevocable bank guarantee / the upfront under this paragraph may be reduced only based on the decision of the Government of Georgia.

2. The unconditional and irrevocable bank guarantee / the upfront shall, during the period of its validity, serve as a security for payment of a fine claimed for nonfulfillment of the obligations due by the buyer.

3. If the amount of unconditional and irrevocable bank guarantee / the upfront is reduced, the buyer shall fill the amount within one month.

4. If the entity in charge of disposing of the state property dissolves the protocol / contract due to nonfulfillment of the obligations assumed by the buyer, the amount of unconditional and irrevocable bank guarantee / the upfront shall be fully transferred to the respective budget.

5. The obligation under this Article to present unconditional and irrevocable bank guarantee / the upfront shall not apply to the buyers who are to be handed the state-owned immovable property via privatization as per the memorandum signed with the Government of Georgia regarding the construction of electric power station.

Article 21. Removed (*10.12.2010 N 3963 effective as of January 1, 2011*)

Article 22. Nullity of the transaction of privatization of the state-owned immovable property

1. The legal and proprietary outcomes of acknowledgement of nullity of the transaction on privatization of the state-owned immovable property shall be prescribed under the Georgian legislation.

2. Statute of limitation on appeal against disputable issues concerning the privatized state-owned immovable property is three years.

Article 23. The management, disposal or and transfer with the right of use of the state-owned immovable property in Autonomous Republic of Abkhazia and Autonomous Republic of Achara

1. In Autonomous Republic of Abkhazia and Autonomous Republic of Achara the state-owned immovable property may be managed, disposed or and transferred with the right of use by the competent structural units of the Ministry in accordance with the rule and within the limits laid down under this Law. Immovable property owned by Autonomous Republic of Abkhazia and Autonomous Republic of Achara shall be disposed of by competent bodies of

executive authority of Autonomous Republic of Abkhazia and Autonomous Republic of Achara in accordance with the rule prescribed under the Georgian legislation.

2. In Autonomous Republic of Abkhazia and Autonomous Republic of Achara the competent structural units of the Ministry within the competence delegated by the Ministry, shall carry out privatization of the state-owned immovable property on behalf of the Ministry.

#### Chapter V. Property placed under state ownership

Article 24. The authorities in charge of disposal of the property placed under state ownership

1. In order to ensure implementation of effective policy of disposal of the movable property placed under state ownership, the Ministry of Finance of Georgia shall be the body duly authorized by the state. The Ministry through the Agency shall be in charge of sale, distribution and destruction of the movable property placed under state ownership.

2. The Ministry of Finance shall carry out official control of the Agency. The Agency shall be managed by its Director General to be appointed and dismissed by the Minister of Finance. The Charter of the Agency shall be approved by the Ministry of Finance of Georgia.

3. The rule of disposal of the immovable property placed under state ownership shall be prescribed under Chapters II-IV of this Law.

#### Article 25. Objectives of the Agency

The objective of the Agency is to take stock of, store, evaluate, dispose of, distribute, sell the state-owned movable property and/or coordinate the measures of its destruction and to solve problems existing in this area.

#### Article 26. The forms of disposal of the movable property placed under state ownership (15.12.2010 N4060)

1. The following shall be the forms of disposal of the movable property placed under state ownership
  - a) sale of the movable property placed under state ownership via auction (including online auction);
  - b) sale of the movable property placed under state ownership via direct sale;
    - b.a) sale of the movable property placed under state ownership using one-to-one negotiation;
    - b.b) sale of the movable property placed under state ownership using a retail shop (including online shop);
  - c) sale of the movable property placed under state ownership through third person;
  - d) distribution of the movable property placed under state ownership;
  - e) destruction of the movable property placed under state ownership;
  - f) transfer of the movable property placed under state ownership by leasing.

2. Director General of the Agency shall be entitled to take decision, in agreement with the Ministry of Finance of Georgia, on simultaneous application of online auction and online shop for selling the movable property placed under state ownership.

Article 27. The rule of disposal of the movable property placed under state ownership

1. The decision on the disposal of the movable property placed under state ownership, in agreement with the Ministry of Finance of Georgia, shall be made by the Agency, except for the cases under paragraph 3 of this Article. *(12.11.2010. N3806)*

2. Movable property placed under state ownership may be sold via direct sale, one-to-one negotiation or retail shop or third party depending on the specificity and/or value of the movable property placed under state ownership.

3. If the value of the goods, falling under the category of perishable products, deprived free of payment for reason of committing the offences under the Law of Georgia on Administrative Offences or deprived free of payment for committing the offences under the Tax Code of Georgia, does not exceed the amount laid down in the Order of the Minister of Finance of Georgia, the decision on its distribution for social purposes shall be made by the body or official in charge of property deprivation upon enforcement of the administrative or tax sanction for confiscation of the goods concerned. *(12.11.2010. N3806 effective as of January 1, 2011)*

4. Movable property placed under the state ownership may be transferred to state and self-governing units, as well as other institutions and organization, with the consent of the Ministry of Finance of Georgia. Movable property placed under the state ownership, depending on its type, may be also used for social purposes. *(12.11.2010. N3806)*

5. Movable property placed under the state ownership that is impossible to use for any purposes shall be destroyed with the consent of the Ministry of Finance of Georgia. *(12.11.2010. N3806)*

6. Movable property placed under the state ownership may be sold using third party with the consent of the Ministry of Finance of Georgia. *(12.11.2010. N3806)*

7. The rule and terms and conditions for setting the price on the movable property placed under state ownership, for taking stock, evaluation and disposal of this property, as well as the rule of distribution of the proceeds of the sale shall be laid down under the Order of the Minister of Finance of Georgia.

Article 28. The rule and deadline for appeal

1. The decision adopted or action taken by the Agency regarding the disposal of the movable property placed under state ownership may be appealed against in accordance with the rule prescribed under the Georgian legislation.

2. The person shall acquire the right under paragraph 1 of this Article upon being notified of the decision adopted or action taken by the Agency and shall remain valid for one year.

## Chapter VI. State-owned movable item

Article 29. The forms of privatization of state-owned movable item and the authorities carrying out privatization

1. Privatization via auction of the state-owned movable item (hereinafter the movable item) shall be carried out by state authority / legal entity of public law to who has been transferred the movable thing with the right of use and/or accounts for it in its balance sheet. Legal entity of public law subject to official control shall have the right to alienate the movable item only with the consent of the body exercising official control

2. If the movable item has not been transferred with the right of use, it shall be privatized via auction by the Ministry / territorial unit of the Ministry, or the President of Georgia, commensurate with the rule under Article 10 of this Law, shall adopt the decision and set appropriate conditions regarding direct sale or direct sale using competitive selection method based on the Ministry's recommendation, and in special cases based on the recommendation of the Government of Georgia.

Article 29<sup>1</sup>. The rule of issuance of hardwood resource obtained as a result of chopping down and special chopping down on the area removed from the state-owned state forest reserves *(11.03.2011 N 4391)*

Hardwood resource obtained as a result of chopping down and special chopping down on the area removed from the state-owned state forest reserves shall be stored on the premises as assigned by the Natural Resources Agency – the legal entity of public law falling under the Ministry of Energy and Natural Resources of Georgia. It shall be issued by the Natural Resources Agency – the legal entity of public law falling under the Ministry of Energy and Natural Resources of Georgia, in accordance with the Decree N242 dated August 20, 2010 of the Government of Georgia on Approval of the Rule of Forest Utilization”.

Article 30. Transfer of the movable item to the insurer upon occurrence of the insured accident

1. Upon occurrence of the insured accident, in the case foreseen under the insurance contract, the state authority shall transfer the movable item owned by it to the insurer in exchange for reimbursement of the price of this item or replacing the damaged item with identical undamaged item, as per the conditions under the insurance contract.

2. The rule and terms and conditions of the transfer of the movable item to the insurer upon occurrence of the insured accident, shall be laid down under the Decree of the Government of Georgia.

Article 31. Setting the privatization price of the movable item, settlement of payment and conduction of transaction on privatization

1. The rule of setting the privatization price of the movable item shall be approved by the President of Georgia.

2. In privatization of movable item, payment shall be settled commensurate with Article 19 of this Law.

3. In privatization of movable item, the sales contract shall be signed between the authority carrying out privatization and the buyer. In privatization of the movable thing via auction, the forms of sales contract shall be approved by the Ministry. The authority carrying out privatization shall be authorized to issue confirmation on winning the auction. In privatization via auction, the sales contract shall be signed within one month after conducting the auction, and in privatization via direct sale by the President of Georgia – within three months after issuing the appropriate act. *(10.12.2010 N 3963 effective as of January 1, 2011)*

4. Privatization revenue earned from privatization of the movable item shall be transferred to the State Budget of Georgia in accordance with the rule prescribed under the Georgian legislation. *(10.12.2010 N 3963 effective as of January 1, 2011)*

5. The Ministry shall be entitled to sign contract with third parties to ensure initiation of privatization of the state-owned movable item.  
*(10.12.2010 N 3963 effective as of January 1, 2011)*

## Chapter VII. Use of State Property

Article 32. The Sites Which the Rules Laid down under this Chapter does not Apply to

The rules laid down under this Chapter shall not apply to:

a) state housing resources (except for heirless residential houses and apartments transferred to and/or passed into the state ownership as per paragraph 4 of Article 1 of this Law);

b) buildings under Ordinance N687 dated August 8, 2005 of the President of Georgia On the Approval of the list of types of basic (nonalienable) property to be transferred to local self-governing unit;

c) state-owned agricultural lands under Chapter II of this Law subjected to privatization, except for the exception as prescribed under this very Law.

Article 33. The forms and terms and conditions of the transfer of the state property with the right of use

1. State property is transferred with the right of use with a definite or indefinite time period, subject to payment or free of payment, via auction or without auction.

2. State property may be transferred with the right of use to the Georgian state authorities, bodies of the Autonomous Republic of Abkhazia and Achara, bodies of the self-governing unit or the legal entities of private law, as well as natural persons and legal entities of private law.

3. Transfer with the right of use of the state-owned immovable property shall be registered by the state authority, bodies of the Autonomous Republic of Abkhazia and Achara or of local self-governing unit, natural person, legal entity of public law or of private law, that has been transferred this property with the right of use.

4. The person accepting the state property with the right of use shall not mortgage the state property, transferred thereto with the right of use, pledge it, encumber it with servitude, conduct transaction on otherwise disposal, or issue individual administrative legal act concerning the immovable property that causes changing of the property owner unless otherwise provided for under this Law.

Article 34. Transfer of the property to the state authority, the Autonomous Republic of Abkhazia or Achara, the self-governing unit or the legal entity of public law

The state authority, the Autonomous Republic of Abkhazia or Achara, the self-governing unit or the legal entity of public law shall have the right to accept and enter in its balance sheet the property owned by natural person or legal entity that has been transferred to him/her by a natural person or legal entity. The property accepted in this manner by the state authority shall be registered as the state property. Property accepted in this manner by the Autonomous Republic of Abkhazia or Achara, the self-governing unit shall be registered as its property in accordance with the rule prescribed under the Georgian legislation.

Article 35. The rule of transfer with the right of use of the property to the state authority, the Autonomous Republic of Abkhazia or Achara, the self-governing unit or the legal entity of public law

1. State authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit shall address the Ministry with the application on initial transfer of the state property with the right of use. Within two weeks after filing the application, the Ministry shall take decision on giving consent on the issue of concern under the application serving as grounds for registration with the Public Registry of the transfer of the state property with the right of use to the appropriate body, or on giving well-founded rejection to transfer the property. If the Ministry rejects the issue of transfer of the state property, it shall be reviewed and decided by the Government of Georgia.

2. After the initial transfer of the state property with the right of use, the state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit shall be entitled, based on the individual administrative legal act of the head of the competent body, to transfer this property with the right of use to other state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit on which the acceptance report shall be signed. The state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit shall have the right to transfer with the right of use the property that is accounted for in its balance sheet, as per the rule prescribed under the legislation.

3. The state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit shall apply, in appropriately well-founded writing on the transfer of the state property with the right of use, to the state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit that has been transferred this property in accordance with the rule prescribed under the Georgian legislation. The rule on filing the

application, on reviewing and deciding upon it shall be laid down under the Decree of the Government of Georgia.

4. The individual administrative legal act under paragraph 2 of this Article shall lay down the deadline for transfer of the state property with the right of use (unless it is transferred without time limit), as well as other conditions of transfer (if any).

5. If the state property accepted with the right of use by the state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit, is transferred with the right of use to other state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit, the contract signed between the Ministry and this body based on which the immovable property had been transferred shall be annulled.

6. If the owner of the property cannot be identified, the state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit shall file to the Ministry the application requesting the transfer the property with the right of use. Within one month after filing the application the Ministry shall take decision on giving the consent on the issue of concern under the application, serving as grounds for the state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit to address the National Agency of Public Registry with the request to make entry about registration of the property as state property and about registration of transfer with the right of use to the same body. If the Ministry fails to decide upon the issue concerned within the set deadline, the state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit shall be entitled to apply to the National Agency of Public Registry with the request to make entry about registration of the property as state property and about registration of transfer with the right of use to the same body.

7. If the owner of the property cannot be identified, the local self-governing unit shall file to the Ministry the application requesting the transfer the property with the right of use. Within one month after filing the application the Ministry shall take decision on giving the consent on the issue of concern under the application, serving as grounds for the local self-governing unit to address the National Agency of Public Registry with the request to make entry on registration of the property as the property of the local self-governing unit, or the Ministry shall give well-founded rejection to transfer the property. If the Ministry fails to take decision with the set deadline, the local self-governing unit shall be entitled to apply to the National Agency of Public Registry with the request to make entry about registration of the property as property of the local self-governing unit.

8. Application of paragraphs 1-6 of this Article shall not be extended to the legal entities of public law, except for political associations of citizens, creative unions and Georgian Apostolic Autocephaly Orthodox Church. Legal entity of public law subjected to official control may transfer the state property owned by it only with the consent of the authority exercising the official control.

9. The state authority, body of the autonomous republic of Abkhazia or Achara or of local self-governing unit or legal entity of public law may transfer the property to the legal entity of public law not having the authority exercising official control over it, with the consent of the Government of Georgia, by using the forms of use provided under the Civil Code of Georgia, with

definite or indefinite time period, subject to payment or free of payment. *(10.12.2010 N 3963 effective as of January 1, 2011)*

Article 36. The Rule of Transfer with the right of Use of the State Property to Natural Person and to Legal Entity of Private Law

1. The state-owned immovable property shall be transferred subject to payment, by using the forms of use under the Civil code of Georgia, via auction to natural person or legal entity of private law by the state authority, with the consent of the Ministry, who has been given this property with the right of use. If immovable property has not been transferred with the right of use, the Ministry shall be in charge of transferring it with the right of use to natural person or legal entity of private law.

1<sup>1</sup>. Natural Resources Agency – the legal entity of public law under the governance of the Ministry of Energy and Natural Resources, shall with the consent of the Ministry issue the lands from forest reserves with the right of agricultural use - for not more than 10 years, and with the right of nonagricultural use – for not more than 49 years. *(11.03.2011 N 4391)*

2. The property may be transferred to a natural person and legal entity of private law subject to payment, free of payment or without auction only with the consent of the Government of Georgia.

3. The Ministry shall transfer the state owned immovable property, privatization of which is prohibited under this Law, without auction only to the companies set up with 50% or more than 50% state-owned shares, with the free-of-payment right to build, free-of-payment usufruct, and lending.

Article 37. Use of the Property Placed under State Ownership and of the State-owned Agricultural Land

1. The property placed under state ownership shall not be transferred with the right of use, except for the cases under Paragraph 4 of Article 27 of this Law.

2. Only the agricultural lands not subjected to privatization may be with the right of use. *(10.12.2010 N 3963 effective as of January 1, 2011)*

Article 38. The Rule of Setting Price for Transfer with the Right of Use of the State Property and the Rule of Settlement

1. The price for transfer with the right of use of the state property shall be approved by the President of Georgia.

2. In transferring with the right of use of the state property, the settlement shall be made in accordance with Article 19 of this Law.

## Chapter VIII. State-owned Intangible Benefit of Property

Article 39. The State-owned Intangible Benefit of Property

1. The state-owned intangible benefits of property are the shares and stock as well as all claims and rights that may be transferred to other entities and intended for creating the tangible benefit for its owner and/or granting its owner the right to claim something to other entities.

2. Using the state property, the Ministry, pursuant to the Law of Georgia on Entrepreneurs, shall found the joint stock companies and limited liability companies and/or nonentrepreneurial (non-for-profit) legal entities.

#### Article 40. The Body Authorized to Disposal of the Shares and Stock

The Ministry shall be authorized to disposal of the shares and stock.

#### Article 41. The Forms of Disposal of the Shares and Stock

1. The following shall be the forms of disposal of the shares and stock:

- a) privatization of the shares and stock;
- b) transfer of the shares and stock with the right of management.

2. Privatization of the shares and stock may be carried out via auction or direct sale methods.

#### Article 42. Privatization of the Shares and Stock via Auction and Direct Sale Methods

1. The auction of shares and stock shall be of two kinds: with conditions and without conditions.

2. Privatization via direct sale of the shares and stock may be carried out by using the direct sale and direct sale via competitive selection methods based on the decision of the President of Georgia in accordance with the rule prescribed under Article 10 of this Law.

#### Article 43. Transfer of the Shares and Stock with the Right of Management

1. The shares and stock shall be transferred with the right of management via auction or upon the decision of the President of Georgia via direct transfer method.

2. The rights of the partner (shareholder) of the company operating with state-owned shares, except for the authorities concerning the disposal of state-owned shares and stock, shall be transferred to Enterprise management Agency, the Legal Entity of Public Law (hereinafter the Enterprise Management Agency) and the Ministry shall carry out official control over it.

3. The Minister of Economy and Sustainable Development shall appoint and dismiss the Chairman of the Enterprise Management Agency, as well as approve the Charter and organizational structure of the Enterprise Management Agency. The work of the Enterprise Management Agency shall be financed from the state budget of Georgia.

Article 44. The Rule on Laying Down the Individual Forms of Privatization of the Shares and Stock and on Transferring them with the Right of Management to other Entities by the Enterprise Management Agency in accordance with the Georgian Legislation

The Minister of Economy and Sustainable Development shall lay down individual forms of privatization of shares and stock and approve the rule on their transfer with the right of management to other entities by the Enterprise Management Agency in accordance with the Georgian Legislation.

#### Article 45. Setting the Privatization Price for Shares and Stock, Settlement and Conduction of Transaction on Privatization

1. The rule for setting the privatization price for shares and stock shall be approved by the President of Georgia.

2. Settlement in privatization of shares and stock shall be made in accordance with Article 19 of this Law.

3. In privatization of shares and stock, the authority carrying out the privatization and the buyer shall sign sales contract. The authority carrying out the privatization shall have the right to issue confirmation on winning the auction. In privatization via auction the sales contract shall be signed within one month after conduction of the auction, in privatization by using direct sale by the President of Georgia – within three months after publication of the relevant act. In privatization of shares and stock the buyer shall be handed the right of ownership upon registering with the competent registering body, simultaneously registering the obligation to pay privatization price. *(10.12.2010 N 3963 effective as of January 1, 2011)*

4. The Ministry shall be entitled to sign contract with third parties who shall ensure to initiate the privatization of the shares and stock. *(10.12.2010 N 3963 effective as of January 1, 2011)*

### Chapter IX. Transitional Provisions

#### Article 46. Measures to be Implemented vis-à-vis the Decree of this Law

1. Within two months after enactment of this Law, the Ministry shall draft and approve the following:

a) Regulation on “the rule of privatization of the forest existing within the territorial boundaries of the settlement”;

b) template of the protocol certifying purchase of forest land parcel;

c) the rule on the disposal of state-owned agricultural land by third parties;

d) the rule and terms and conditions on the transfer of the state property to the ownership of natural persons and/or legal entities of private law in exchange for counter transferring the equally valuable property to the state ownership.

1<sup>1</sup>. Before January 1, 2011, the Ministry shall draft and approve the rule and terms and conditions on initiation of privatization of the state-owned agricultural land by third parties. *(10.12.2010 N 3963 effective as of January 1, 2011)*

2. Before May 1, 2011 the Ministry shall ensure to approve the rule of conduction of electronic auction in the disposal of the state property.

3. Before June 1, 2011 the National Agency of Public Registry – the legal entity of public law operating under the governance of the Ministry of Justice of Georgia, shall ensure identification of the lands of state forest reserves and lands of former kolkhoz and sovkhoz forests, preparation of appropriate drawings and submission to the Government of Georgia of the draft Decree on setting the boundaries of state forest reserves.

3<sup>1</sup>. Before February 1, 2011 the Government of Georgia shall ensure to set the initial price on agricultural land parcel for each administrative territorial units on an individual basis. *(10.12.2010 N 3963 effective as of January 1, 2011)*

4. Within two months upon enactment of this Law the state authorities shall ensure compliance of appropriate bylaw normative acts with this Law.

Article 47. Interim rule regulating the application for privatization/sale of the state property as well as for privatization via direct sale of the state-owned leased agricultural land parcel and regulating the application for finalization of the procedure commenced on leasing the state-owned agricultural land parcel

1. Before approving the rule of conduction of online auction as prescribed under Article 46.2 of this Law, the state property shall be disposed of via auction by using public or online auction the information on which shall be published on the Web site of the entity disposing of the state property and/or on [www.eauction.ge](http://www.eauction.ge) Web site, to be deemed as official publication of the information. In order to ensure publicity and access to the information, the information on the privatization of the state property by using the public auction method shall be also published in the newspaper “24 Hours”. *(10.12.2010 N 3963 effective as of January 1, 2011)*

2. Removed *(10.12.2010 N 3963 effective as of January 1, 2011)*

3. Before this law becomes effective, a person shall address the Ministry, its territorial unit, or competent body of the executive authority of the autonomous republics of Abkhazia and Achara operating within the competence delegated by the Ministry, with the application to finalize the procedure commenced on leasing the state-owned agricultural land parcel no later than December 31, 2010. After expiry of this deadline, the state-owned land parcel (parcels) shall be sold commensurate with the rule prescribed for privatization of the state-owned, un-leased agricultural land parcel.

4. For privatization via direct sale of the state-owned agricultural land parcel and farm building and facility (facilities) and/or multiyear plantations attached thereon, the lessee shall address the Ministry, its competent territorial unit or competent body of the executive authority of the autonomous republics of Abkhazia and Achara operating within the competence delegated by the Ministry, with the application no later than May 1, 2011.

5. The rule applicable before enactment of this Law shall apply to the relations involving the disposal of state property as commenced before enactment of this law.

6. Until December 1, 2010, application of this Law shall not be extended to the cases under Article 10.3.f of the Law of Georgia on State Procurements.

Article 48. Modification of the conditions of the transfer with the right of use of the state property, exemption from the sanctions imposed/to be imposed for failure to meet the conditions of the transfer with the right of use

1. Persons who, before November 19, 2009, had accepted the state property with the right of use shall be exempted from sanctions imposed / to be imposed before June 1, 2010 for nonfulfillment of the obligation to periodically inform the Ministry on fulfillment of the obligation assumed under the contract, to insure property and/or to cover utilities charges.

2. Persons accepting the state property with the right of use shall have the right to address the Ministry, no later than September 1, 2010, with the request to be exempted from the sanctions imposed for nonfulfillment of other obligations assumed under the contract and/or with the request to amend/revise the obligations. The Ministry shall be entitled, based on the principles of public and private interests, in the case of well-founded need, with the consent of the Government of Georgia, adopt the decision on the amendment / revision of the conditions of the contract signed in transferring the state property with the right of use and/or on the exemption of sanctions imposed for nonfulfillment of any obligation.

Article 49. Modification of the state property privatization conditions, exemption from sanctions imposed/to be imposed for failure to meet privatization conditions

The Ministry shall have the right, for the sake of supporting the investment climate, based on the principles of protection of public and private interests, if the need is well-founded, with the consent of the Government of Georgia, to adopt the decision with regard to the buyers of the state property who have addressed the Ministry no later than July 1, 2010, with the request to be exempted from sanctions imposed for nonfulfillment of other obligations assumed under the protocol / contract and / or with the request to amend / revise the obligations, on the amendment / revision of the terms and conditions of the protocol / contract signed in the privatization of the state property privatized in accordance with the earlier applicable form of auction or privatization, or of the terms and conditions of the sales contract (except for the privatization conditions as prescribed by the President of Georgia) signed in privatization of the state property privatized via direct sale and/or on exemption of sanctions imposed for nonfulfillment of any obligation. If the issue concerns amendment / revision of the privatization conditions as prescribed by the President of Georgia, the Ministry shall review the application of the state property buyer and refer the case to the Government of Georgia with the appropriate proposal (draft of the legal act). The Government of Georgia then shall be entitled to, for the sake of supporting the investment climate, based on the principles of protection of public and private interests, if the need is well-founded, submit to the President of Georgia the proposal on the amendment / revision of the privatization conditions prescribed by the President of Georgia for the state property privatized via direct sale. The decision on the amendment / revision of the privatization conditions of the state property prescribed by the President of Georgia, shall be made by the President of Georgia.

Article 50. Invalidated normative acts

Upon enactment of this Law the following shall become invalid:

- a) Law of Georgia, dated July 8, 2005 on Privatization of State-owned agricultural land (Legislative Herald of Georgia, N42, 29.07.2005, Art. 303);
- b) Law of Georgia dated May 30, 197 on the Privatization of the State Property, on the Privation and the Transfer with the Right of Use of the Property of Self-Governing Unit (Official Gazette “Notifications of the Parliament”, N29-30, 9.07.1997, p. 15);
- c) Law of Georgia, dated December 25, 2009, on the Disposal of the Property Placed under State Ownership (Legislative Herald of Georgia, N50, 31.12.2009, Art. 392);
- d) Law of Georgia, dated November 3, 2009, on Transfer with the Right of Use of the State-owned Property (Legislative Herald of Georgia, N35, 19.11.2009, Art. 245).

Chapter X. Final provision

Article 51. Enactment of the Law

This Law shall become effective upon its publication.

President of Georgia

***Mikheil Saakashvili***

Tbilisi,

July 21, 2010.

N 3512 – RS

## TYPICAL PRINCIPLES AND PROCEDURES OF PUBLIC COMPETITIVE TENDERS

### PREPRIVATIZATION STEPS

- **Preprivatization restructuring** by the state should be limited to certain balance sheet actions (e.g., state debt reduction) and organizational changes (such as closures, workforce reductions, and transfers of assets surplus to requirements). Investment obligations or conditions concerning technology changes, capital investment, and major purchases should in most cases be left to the new owners, not imposed by government officials. In the case of strategic assets (e.g., where public service obligations exist), buyers should be put under certain restrictions to prevent the services being affected (e.g., bar on enterprise liquidation, sale, assets transfer, change of business).
- Privatization of monopolies (or creation of monopolies through privatization) without in advance **establishing a proper framework for sector regulation** or competition carries substantial risks for a government. Before privatizing natural monopolies, governments should make efforts to restructure the industry to promote competition, accompanied by clear regulations and credible enforcement (e.g., in the health sector).
- For example, governments will often develop transparent and predictable regulations and incentives to **reduce the risk** and costs associated with **environmental problems**. In most cases, this means the government will have to assume some known environmental risks and indemnify the buyer from unknown risks. Approaches that have been used include allowing private owners to set aside part of the purchase price for cleanup (the Czech Republic, Poland), indemnifying private owners for costs incurred during cleanup (Bulgaria, Germany), and lowering the purchase price but making the buyer responsible for cleanup (Argentina).
- Most successful privatization programs have placed a heavy emphasis on **education of the public** and advertising expected sales. Special efforts to inform institutional investors have encouraged them to participate in many privatizations.
- Use of **presale feasibility studies** for substantial enterprises is recommended—covering valuation range, transaction structuring, legal and regulatory due diligence, accounting and environmental/social audits etc. Important when selling strategic enterprises, is to ensure maximum prospect of a successful sale and value achieved.
- Governments have a **fiduciary responsibility to citizens** when privatizing an asset. That responsibility is to sell privatizable assets at or above their fair market value, and to take every precaution to ensure that this happens. Agreeing to sell state assets below their market value is tantamount to favoring a buyer, and it deprives the state of needed financial resources. While this may sometimes be politically desirable — for example, in the case of selling to employees of a state company — transparency is crucial. Thus the size of any discount offered should be determined, with reasons given and publicly disclosed.
- **Specialist consultants**—especially financial adviser—have a clear role to play in case-by-case privatization of (mainly) larger and more complex enterprises. Although local experts can be used, governments should not hesitate to call on the reputable privatization experts like investment banks, environmental experts, accountants, and

lawyers. Many privatization programs have suffered because governments, lacking qualified personnel, could not manage the process effectively.

## SALE PROCESS

- **Clear and predictable bidding or sale process** notified to bidders upfront by means of tender rules contained in a set of tender documents to which all bidders commit to abide by.
- **Prequalification criteria for bidders** should be set prior to any bidding process for a valuable asset or a large enterprise, in order to ensure that potential buyers can demonstrate adherence to the necessary international standards of corporate governance, annual financial audits, and transparency in their businesses. Offshore companies (in particular, newly incorporated ones) should be discouraged by requiring at least three years audited accounts from the company, or at the least from each of their major shareholders. Corporate bidders should also have a minimum asset value in their balance sheets and the management should demonstrate significant prior experience in the business that they are proposing to invest in. Requiring an upfront and significant bid bond or other security from each participant also separates the genuine from the more speculative bidders.
- **Inclusion of proposed contract terms in bidding documents** (including any minimum investment conditions) that are circulated to bidders before commencement of bidding, both to discourage investors from reneging on commitments made or proposing radically different contract terms during the process and also to prevent governments from imposing any significant new obligations during contract negotiations, any of which can cause the premature annulment or cancellation of a bidding process if not prohibited from the outset.
- It is important in a bidding process to **restrict bidders' access to government** officials, except through specified and controlled channels and only then on the basis that all questions and comments from bidders on documents or any aspect of the bidding process, together with any answers provided by the state selling authority, must be shared between all bidders.
- The tender rules must **specify the number of bidding rounds** following initial bid submission, and must **give deadlines for each stage** of the bidding process. Failure by a bidder to meet a deadline (e.g., for submission of a bid) results in automatic disqualification of that bidder.
- Finally, the **privatization bid evaluation and award process must be predefined** in the bidding documents and be carried out in a transparent manner so as to avoid corruption and controversy. Best price bids are simplest, but where price is blended with other factors e.g., quality and amount of investment, a weighted formula is normally used.

## LIST OF MINISTRIES AND STATE AGENCIES WITH INVOLVEMENT IN STATE PROPERTY

Responsibility for the privatization process lies primarily with the **Privatization Department** of the MoESD. The Privatization Department has several key sub-divisions in the performance of its functions—**Privatization Management Division**, **Division for Communication with Territorial (Regional) Units**, **Division of Relations with Private Sector**, and **Citizens' Service Centre**.

Other key participants in the process include:

**Chancellery**, which is responsible for receiving and sorting applications from interested parties

**Department of State Property Management Policy**, a department of the MoESD, which carries out (i) management of state property, (ii) transfer in permanent or temporary usage to state organizations, (iii) transfer of state property for temporary usage to private sector organizations (lease), and (iv) transfer of state property to local self-governing units (municipal and district councils)

**Legal Department** of MoESD, which is responsible for legal assurance of the process, including contracts, decrees and analysis and check of order drafts. Its activities are executed with the help of the **Legal Assurance Division** and the **Contractual Obligations Monitoring Division**

**Finance and Logistics Department** of the MoESD, which controls financial resources flow, with the help of **Accounting**

**EMA**, a legal entity of public law under the governance of the MoESD which is responsible for managing the state's shareholdings in companies, including sub-divisions, such as the **Financial Analysis Division** which provides financial analysis of enterprise performance; the **Restructuring and Liquidation Division** which handles enterprise liquidation; the **Industrial Economy/Social Infrastructure Division** which is responsible for monitoring and management of state owned enterprise, initiator of liquidation, preparing base for the process; and the **Administration** which is responsible for general management of agency and updating of the general database

**Territorial (Regional) Units of MoESD**, which mainly accomplish state property management and privatization functions in regions of Georgia by the order of the MoESD

Key external bodies include:

**NAPR**, an independent LEPL under the supervision of the Ministry of Justice, which is responsible for national registration of property ownership and its liabilities, and for the national cadaster

**Revenue Service of MoF** which provides necessary information, especially relating to the sequestration of enterprise property, and with agreement, removes it

**Service Agency** of the MoF which under the LSP is responsible for the sale, distribution, or destruction of movable property placed under state ownership

**Local self-governing units** which comprise either municipal or district/regional authorities which have powers of disposal of property under their ownership in accordance with applicable laws

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