COMMERCIAL LAWS OF GEORGIA
AN ASSESSMENT BY THE EBRD

October 2013

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Legal system

Constitutional and political system

Georgia’s Constitution was adopted in 1995. It proclaimed Georgia as a unitary democratic republic, with the Republic of Adjaria holding autonomous status. The legal status of the breakaway regions of Abkhazia and South Ossetia is not mentioned in the Constitution of Georgia and still remain undefined.

The Constitution has been amended several times since its adoption, most notably, in 2004 and in 2010. The 2004 amendments, initiated by the newly elected President in the aftermath of the “Rose Revolution”, strengthened the powers of the President to dismiss the Parliament and created the post of Prime Minister. The 2010 amendments reduced the Presidential powers in favour of the Prime Minister and the government, representing the country’s move from a presidential to a mixed parliamentary system.

The legislative branch is represented by a unicameral parliament comprised of 150 deputies. The Parliament is authorised to express a vote of no-confidence in the Government. The President of Georgia is still the Head of State elected for a five-year term by popular vote but is no longer responsible for leading and exercising the internal and foreign policy of the state, the power which has been transferred to the Government headed by the Prime Minister. The President nominates and approves the candidature of Prime Minister; however, the substantive selection is with the Parliament that should approve the candidate by a simple majority vote.

The executive branch is represented by the Government headed by the Prime Minister and composed of ministers. The Prime Minister is appointed by the President. Ministers are appointed by the Prime Minister; with Presidential authorisation no longer required. The Government is no longer formally obliged to report to the President. The Parliament may proclaim a vote of no confidence in the Government (with a minimum of two fifths of MPs required) and with a complex procedure to follow.

Judicial system

Georgia’s judiciary comprises a three-tier system of courts of general jurisdiction, which hear all criminal and civil matters, including commercial cases. There are no specialist chambers for commercial or other matters at first instance. Appeal courts and the Supreme Court have general civil chambers. Responsibility for management of the judicial system is vested in the High Council of Justice, which is an independent authority. This body is also responsible for professional development and qualification of judges.

The EBRD Judicial Decisions Assessment 2011 found the quality of court judgments in commercial law matters in Georgia to be among the best in the Commonwealth of Independent States. Factors adversely affecting the quality of court decisions included certain gaps in commercial areas such as competition law, as well as the judges’ high caseload. In addition, it was considered that judges would benefit from further judicial training in commercial law and market practice. Implementation of commercial law decisions was considered to be very effective. Even so, there remains a backlog of unenforced decisions and certain inefficiencies in the functioning of enforcement agencies. The recent introduction of a dual system of private and government bailiffs is aimed at raising enforcement standards.

The most notable recent improvements in the Georgian judiciary lie in the area of judicial independence and impartiality. This is partly reflected in the Judicial Decisions Assessment, which found Georgia scoring well on the indicator of perceived impartiality of written decisions. However, there appears to be a broad consensus that real progress has been made in raising the actual level of judicial conduct and impartiality in judicial decision-making. This is attributed to a concerted and multi-layered anti-corruption campaign initiated by the Georgian government in 2003. In respect of the judiciary, this encompassed thorough retraining of judges, with those passing the requalification tests being appointed for longer terms and receiving a higher salary. Furthermore, a reform was introduced prohibiting communications between judicial officers and any party (private or public) having an interest in litigation before the courts. Substantial penalties apply in relation to any violation of these provisions.

The anti-corruption campaign has achieved positive results, evidenced by an increase in public confidence in the courts. Many local lawyers believe that bribery of judges has been all but eliminated in Georgia, at least at the first instance level. This is reflected in Georgia’s improved standing in corruption-related metrics, such as the EBRD/World Bank Life in Transition Survey, which found that the level of perceived corruption in Georgia is now as low as that in western European countries. A further important factor is that the government has clearly been active in disseminating its work under the anti-corruption campaign.

However, ensuring full judicial independence requires further efforts. Courts are still believed to show deference towards the state in cases involving state interests or parties. In criminal matters, young judges are often overshadowed by a well-resourced and powerful prosecutor’s office; the introduction of a jury system is intended to address this imbalance.
Further, the lack of full judicial tenure and the potential for relocation to remote jurisdictions remain threats to judicial independently. The government is continuing its efforts to strengthen the judiciary and address remaining concerns. Most notably, from 2013, judges will be appointed to the bench for life, rather than renewable terms.

Recent developments in the Investment Climate

Macroeconomic performance has been strong recently. The country’s successful stabilisation and recent performance have been recognised by the markets. Several international rating agencies upgraded their ratings of Georgia’s sovereign debt. The risk premium paid by the country narrowed to around 300 basis points as of September 2012. Georgian Railways, Georgian Oil and Gas Corporation (GOGC) and the Bank of Georgia have been able to tap international markets. However, an international placement of the national railways’ shares, scheduled for May 2012, had to be postponed in light of the difficult financial markets environment.

However, while the short-term macroeconomic outlook is positive as broad-based growth is expected to continue at a fast pace, benefiting from credit expansion, public and private investment and remittances, the current account deficit remains large (at 12.5 per cent of GDP in 2011) and the level of the financial sector’s dollarisation remains high although declining. The stock of external debt and overall external rollover needs are high for an emerging market economy. The uncertain global environment warrants continued engagement with IFIs. Replenished official international reserves and the precautionary Stand-By Arrangement with the IMF would ensure the country’s high current account deficit can be financed, should private sector flows reverse, and exchange rate movements can be smoothed to avoid destabilising the financial sector. The central bank mandated commercial banks to hold additional capital as a buffer for potential exchange rate movements.

Recovery of private investment remains a priority. The government established a fund to support private sector investment. The Partnership Fund (PF), endowed with equity in the country’s largest state enterprises (including Georgian Railways and GOGC), was established in June 2011 and commenced operations in the spring of 2012. It is intended to support commercially oriented projects in priority sectors in the form of minority equity stakes and debt financing. To ensure that the PF is transparently managed, it was set up as a joint stock company and will be subject to IFRS reporting and rating reviews by the international rating agencies. The fund’s operations will not benefit from explicit state guarantees. However, further measures will be needed to strengthen the fund’s governance and limit the associated fiscal risks.

Georgia’s comparatively good investment environment has been affected by forceful revenue collection measures. With an ease of doing business ranking of 9th (out of 183 countries), Georgia is the best-rated country in the transition region in the 2013 World Bank’s Doing Business Report, its first appearance in the top 10. Large-scale privatisation is very advanced, tax and customs bodies are generally well run, and tangible results have been achieved in fighting corruption. However, over the past year, the tax administration has pursued aggressive tax collection measures, raising concerns about the magnitude and fairness of various penalties. The tax code was amended in January 2012 to allow for seniority of tax liabilities over secured lenders – potentially putting in question security of mortgages and other secured loans – a measure that was later reversed. At the same time, to improve efficiency of, and confidence in, the tax system the authorities have implemented electronic tax filing, improved customs clearance procedures, introduced advanced tax ruling option binding on the tax authority and created a tax ombudsman office.

Freedom of information

Freedom of information (FOI) was initially set out in the Georgian Constitution, 1994, article 41 specifies:

Every citizen of Georgia shall have the right to become acquainted, in accordance with a procedure prescribed by law, with the information about him/her stored in state institutions as well as official documents existing there unless they contain state, professional or commercial secret.

Despite this however there was no law in existence which defined public information or described the procedures for requesting information or indeed how to appeal if the request was rejected. In 1999 the General Administrative Code of Georgia was enacted and chapter 3 of the code was drafted to deal with these issues.
Recently the government of Georgia has published a decree concerning online requests for information and proactive disclosure of information.

The decree published July 26 2013 follows through on commitments made in the context of Georgia’s action plan as a member of the ‘Open Government Partnership’ (OGP - http://www.opengovpartnership.org/).

The decree clarified the Ministry of Justice’s implementation role and relationship with other government entities regarding Georgia’s OGP action plan.

The decree contains seven sections, defining standards of Public information disclosure, rules of request of electronic request of public information and the list of information to be published proactively. Agencies are required to create websites and to establish registries and automatic confirmation systems for electronic requests. Despite this, however, the cost of requesting copies of official documents is viewed as prohibitively high and restricts access to information, therefore not acting entirely in the public’s interest.

Also more recently Georgia was shortlisted for the 2013 Open Government Partnership’s ‘Bright Spots’ prize—an award showcasing inspiring examples of how open and accountable government can change people’s lives. The prize ultimately went to the Philippines, but Georgia’s endeavors were noted as “making significant progress in consolidating democratic institutions, including through its commitments under the Open Government Partnership.”
Commercial legislation

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities. These relate to investment in infrastructure and energy (concessions and PPPs, energy regulation and energy efficiency, public procurement, and telecommunications) as well as to private-sector support (corporate governance, insolvency, judicial capacity and secured transactions).

Detailed results of these assessments are presented below starting with infrastructure and energy and going into private sector development topics.

The completed assessment tools can be found at www.ebrd.com/law.

Infrastructure and Energy

Concessions and PPPs

The Georgian Law (Law of Georgia "On the Procedure for Granting Concessions to Foreign Countries and Companies") was adopted in 1994.

In addition, numerous government statements contain an implicit general policy framework for improving the legal environment and promoting PPP in Georgia.

The 2012 EBRD Concession/PPP Laws Assessment (The “2012 Assessment”) found Georgian legislation to be in low compliance with international standards. The Assessment revealed that the Law has much room for improvement as far as its scope of application is concerned (see Chart 1). In particular, concessions are defined as "long-term leasing agreements" and seem to be limited to natural resources and activities related thereto. In fact, strictly speaking the Law has rather limited applicability to PPP in its common sense. Furthermore, the Law does not clearly define a Contracting Authority and as one can see from its title domestic investors are discriminated against. The Law provides for the adoption of a list of objects that can or cannot be subject to concessions but no such list could be identified.

Moreover, the Law contains very few provisions regarding the selection of the concessionaire and refers to regulations in this respect. However, no such regulations could be identified. In addition, the law refers to the establishment of a special register of concession agreements, but such register could not be identified either. Thus, the selection procedure is insufficiently regulated. The Law contains very few elements regarding the project agreement, government support and financial securities. Furthermore, the possibility of international arbitration is not clearly provided for.

The Law contains a certain number of positive elements. It has a reference to such issues as the protection of rights and security guarantees, the right of the concessionaire to manage its own products and profits after paying all dues and taxes and the obligation of the Contracting Authority to reimburse for the damage suffered by the concessionaire due to "illegal acts of state bodies", the concessionaires' right to bring claims to the court or to the arbitration court "against public bodies for their abuse of power". 
Chart 1 – Quality of the PPP legislative framework in Georgia

Note: The extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the “web”, the more closely concessions laws of the country approximate these standards.

Source: EBRD 2012 PPP Legislative Framework Assessment (LFA)

At the same time, the 2012 Assessment has found that there are significant deficiencies in implementing the PPP laws in practice, including with respect to the PPP policy framework, enforcement of the legal framework and institutional framework (see Chart 3). There are no on-going concessions projects in the country.

As the 2012 Assessment revealed, if Georgia would like to develop PPP mechanisms in infrastructure and public works and services, certain provisions of the legislation have to be amended in order to bring the legislative framework in compliance with international standards. A first step towards improvement could be the amendments to concession definition and sectors concerned; the adoption of numerous legal texts as referred to in the Law; expanding the law to the usual sectors where PPPs are common.

Developing a PPP/Concessions policy aimed at reforming the legislative framework would benefit the reform process.

Despite the existence of numerous positive elements, the Law does not constitute a sufficiently solid legal basis for the development of PPP. The government should amend the flawed and outdated provisions of the 1994 Law that have only since been slightly amended in 2010.
Energy

Electricity

Georgia performs below average in comparison to other countries in the EBRD region that are observers to the Treaty establishing Energy Community. The recent EBRD energy law reform dimensions assessment project has shown that regulatory independence and tariff structure are the key strengths of the country’s electricity framework, while private sector participation, tariff structure and public service obligations are its main weaknesses (see Chart 3).

From an institutional perspective, the regulator’s autonomy could be enhanced by control over its budget. Transfer of its headquarters from the capital presents challenges for coordination with the Ministry of Energy; but overall, the regulatory structure is appropriate and responsive to the needs of the electricity and gas sectors with significant infusion of private investment and diversity of participants. Within the electricity sector, Georgia has existing hydro power capacity and potential for further development, along with excess transmission capacity. It is implementing a strategy to facilitate sale of its excess capacity in the summer and increase its hydro facility capacity overall. The construction of a high voltage line to Turkey will encourage Georgia’s potential for export to Turkey and Western Europe through Turkey. These efforts to step up investment and export are triggering, in turn, the need to further develop its market rules, a process currently underway.

The Ministry of Energy has primary responsibility over policy in the energy sector. Specifically, the Ministry of Energy is in charge of drafting the national energy policy and submitting it to the Parliament for approval, and for developing and implementing short, medium and long-term strategies and priorities for the power sector in the country. The relevant regulatory body is the Georgian National Energy and Water Supply Regulatory Commission (GNEWRC). GNEWRC is an autonomous legal entity led by a Chairman and four other Commissioners, who are appointed and dismissed by the President of Georgia.

Note: The extremity of each axis represents an ideal score, that is, a fully effective legal framework for PPPs.
Source: EBRD 2012 PPP Legal Indicator Survey (LIS).
Electricity market participants are producers (mainly hydro power and thermal power plants), distribution companies, the Electric System Commerce Operator (ESCO), the transmission companies and the dispatch licensee. There is no separate Transmission System Operator (TSO) or distribution system operator. Instead, traditional TSO functions are split between the ESCO and the Dispatch Centre. The ESCO, a state-owned enterprise, is responsible for balancing, including emergency export/import and exports of surplus power not sold through bilateral contracts. Though it does not have a licence from the regulator, the fee it charges for its services is regulated by the GNEWRC. The Georgian State Electrosystem (GSE), which holds a transmission and a dispatch licence, collects dispatch and transmission tariffs set by the GNEWRC for provided services. GNEWRC sets separate tariffs for activities listed above based on cost-of-service principles. The current tariff methodology was issued by the GNEWRC in 1998 and has not been amended since then. The existing tariff methodology is based on a cost-plus, “postage stamp” model, with transmission and dispatch companies receiving a specific tariff per kWh supplied to the consumers, regardless of distance. Tariffs for network service are set in accordance with the voltage levels. Block/consumer tariffs are set by the consumed electricity volumes. The regulator cannot reduce the tariffs of its licensees on its own initiative except subject to limited conditions, though the regulator can request data on its own initiative and gather information regarding appropriateness of the tariff. If a licensee requests a tariff increase, the regulator is empowered to change the proposed tariff as long as certain conditions are met, such as protection of consumers from monopoly prices and sufficient return for the investor to support rehabilitation and development of the sector through attracting investments. The existing tariff and revision obligations are set on a case-by-case basis. Some tariffs remain in effect for specified periods, normally indicated in the tariff resolution. Others are provided in the tariff resolution and are in effect until revision. For example, a Memorandum between the Government and Telasi grants a special distribution tariff to the licensee, which gives Telasi tariff protection through 2015, subject to minor adjustment. The law allows for priority access for domestic production. There is no overarching grid.
code; but separate technical and access rules cover access to the high voltage grid and the distribution network, and as of 2006, market rules are adopted by the Ministry. The Market Rules have undergone several revisions, with new draft rules under review in mid-2009 and ongoing discussions regarding the further amendments to support increased levels of export and import that may result from ongoing expansion of the infrastructure.

At present the transmission line is not at full capacity. Georgia relies on hydro power, with excess capacity in the summer months and a deficit in the winter months. Due to current infrastructure limitations, Georgia has minimal opportunity to export its excess capacity to markets with an energy deficit. Historically, Georgia has received the majority of its imported electricity from Russia. The Government of Georgia has made investment in new hydro power development a priority, with the aims of ensuring security of supply over the winter months and supporting its economy through export in the summer months. The EBRD together with the EIB and KFW is supporting a loan to the Government for the building of a high voltage line to Turkey to encourage Georgia’s potential to become a large exporter to Turkey and to Western Europe through Turkey. Georgia already has created two websites designed to convey information regarding its legal framework and investment environment (www.minenergy.gov.ge; www.georgiahydroinvest.com). Both of these sites are a good platform for conveying additional information to potential investors.

Overall, absent political obstacles, and continued efforts to develop its regulatory framework consistent with best practices, as reflected by, e.g., its observer status in the Energy Community, Georgia has the potential to develop its hydro power export and transit services with the participation of private investment.

Gas

With respect to its gas market, Georgia performs below average with respect to countries of the EBRD region that are observers to the Treaty establishing Energy Community. The recent EBRD energy law reform dimensions assessment project has shown that regulatory independence and tariff structure are the key strengths of the country’s electricity framework, while market framework, private sector participation and public service obligations are its main weaknesses (see Chart 5).

Chart 4 – Quality of energy (gas) legislation in Georgia

Note: The spider diagram presents the sector results for Georgia in accordance with the benchmarks and indicators identified in an assessment model. The extremity of each axis represents an optimum score of 100 that is full compliance with international best practices. The fuller the “web”, the closer the overall regulatory and market framework approximates international best practices. The results for Georgia are represented by the green area in the centre of the web.

Source: EBRD 2011 Energy Sector Assessment
The Georgia gas sector is made up of the state-owned Georgian Gas and Oil Corporation with daughter company Georgian Transportation Company (the transportation licensee); the privatised distribution company, KazTransGaz Tbilisi, owned by the Kazakhstani Company KazTransGaz and regional gas companies mostly owned by Azerbaijani state company SOCAR and the company Itera. At present, a special Manager was appointed for “KazTransGaz Tbilisi” in accordance with the Georgian law on licences and authorisations. The transportation licensee is responsible for meeting suppliers’ instructions for natural gas supply, cut-off or re-supply, and compliance with safety standards.

According to the Parliament’s Resolution adopted in June 2006, the following are the priorities of the Georgian state policy in the gas and energy sector: (a) rehabilitation of gas units, (b) release of such units from debts and their privatisation, (c) diversification of gas supply, and (d) formation of a transparent and liberal energy market.

By 2008, Georgia’s natural gas sector, with the exception of the main pipeline system, was largely privatised. Currently, Georgia has four suppliers and three routes. About 70% of the country’s demand (regulated part of the sector - consumption by households and thermal generation) for natural gas is supplied under the long-term contract with SOCAR. The remaining 30% is commercial consumption and deregulated. Correspondingly, consumers under this segment are free to choose any supplier and negotiate gas price.

Relations among natural gas suppliers, transportation and distribution licensees and direct customers are controlled by natural gas market regulations. Parties involved in natural gas sale and purchase or transportation procedures conclude bilateral or multilateral agreements.

In September 2007, the gas sector was partly reformed through revision to the Law on Electricity and Natural Gas. The law authorises the Ministry of Energy to take a decision on deregulation or partial deregulation of the gas market, which it did by Order No. 69 (25/29/2007). Specifically, natural gas supply activities and natural gas wholesale suppliers were deregulated; in addition, delivery activities for retail consumers within the boundaries of the Tbilisi administrative territory were partially deregulated.

Gas tariffs remained unchanged for the distribution companies that are responsible for supplying gas to the consumers living in their distribution area. The marginal tariffs were set for natural gas supply and consumption for retail consumers falling under the deregulated gas sector and the distribution and transportation tariffs remain fixed.

A similar tariff framework, as identified for electricity, applies for gas. New supply routes and suppliers were introduced, security of supply has increased significantly, and gas supply has been deregulated. In the natural gas market the licences are mandatory for the gas transportation and distribution. Natural gas supply and transportation system connection procedures are overseen by market rules, issued by the Ministry. The 2005 amendments to the Law on Electricity and Natural Gas have stripped some rulemaking powers from the regulatory authority and transferred these to the Ministry of Energy in the gas sector as well as the electricity sector. The amended law gives the Ministry of Energy the authority to approve the natural gas balance and the natural gas market rules. The rules require that a third party seeking access to the transportation system submit to the transportation licensee a special request for connection to the transportation system. The transportation licensee may decline the request only if the connection to a licensee’s or direct customer’s natural gas transportation system may have a negative impact on the whole transportation system. Connected facilities become operational upon covering all the costs of works carried out for connection to the system.

In the gas and oil sector, Georgia already benefits from its important transit role. Four pipelines - BTC and SCS within one ROW transporting petroleum and natural gas from the Caspian fields of Azerbaijan through Georgia to Turkey, commenced operations in 2005 and 2006, WREP Baku-Supsa pipeline transporting oil to the Black Sea has been in operation since 1997 and North-South gas pipeline serving transit to Armenia. Georgia receives a portion of the transported fuel as a transit fee. Georgia has a strong strategic role to play as a transit country, though geopolitics continues to threaten its transit potential. The Ministry, not GNERWC has monitoring authority over technical rules and gas balance.
Energy efficiency/renewable energy

The Law of Georgia on Electricity and Natural Gas of 1997 (with 2005 and 2007 amendments) is the centrepiece of the country’s legal framework in the energy efficiency and renewable energy sectors.

There is no dedicated law on energy efficiency in Georgia. The country has received technical assistance with the drafting of a general energy efficiency law in 2007 but the draft has not been publicly released or submitted for consultation.

At present, Georgia does not have any primary legislation dedicated to renewable energy either, though aspects relevant to renewables exist in the energy legislation, as hydro power has long been the most important electricity source in the country. In fact, Georgia has one of the largest undeveloped hydro power potentials in the world at about 32 TWh per year. Georgia’s potential hydro power production is roughly 7.27 MWh per capita, which is considerably higher than that of the world’s biggest hydro power producers, Norway and Canada.

Though Georgia has wind and solar potential, hydro power offers the greatest present and future renewable energy source for the country and the government is actively seeking to attract more investment to the sector. A recent amendment to the Law on Electricity and Natural Gas allows the Electricity System Commercial Operator to buy hydro power produced by new hydro power plants (HPPs) at the long-term fixed tariff during winter three months. The activities of all newly constructed HPPs are also deregulated, such that they fall outside of Georgian National Energy and Water Supply Regulatory Commission’s (GNERWC) regulation on prices and licensing.

Within the electricity sector, Georgia has existing hydro power capacity and potential for further development, along with excess transmission capacity. It is implementing a strategy to facilitate sale of its excess capacity in the summer and increase its hydro facility capacity overall. The construction of a high voltage transmission line to Turkey will encourage Georgia’s potential for export to Turkey and Western Europe through Turkey. These efforts to step up investment and export are triggering, in turn, the need to further develop its market rules, a step currently underway.

A more dedicated policy approach is needed with regard to promoting energy efficiency, including developing general energy efficiency legislation and institution setting, introducing procedures for ensuring adequate environmental standards and regulation of waste management. Georgia has to harmonise the legal and regulatory framework by improving the environment for the private sector and introducing a modern and dedicated renewable energy law.

Public procurement

The current Public Procurement Law (PPL) was adopted in 2009 and introduced eProcurement tools and procedures in Georgia. The State Procurement Agency (SPA) was established in 2012 as a national public procurement regulatory authority in Georgia. It also manages eProcurement system for public sector as well as prepares and manages central purchasing initiatives for the Government of Georgia. The chairman of the CSP is appointed by the Prime Minister of Georgia. A review body – the Dispute Resolution Board (DRB) has been also appointed in 2012 and decides on complains related to public procurement procedures.

The PPL in Georgia is based on competition, transparency and non-discrimination principles and the Georgian eProcurement system supports procurement planning, tendering, monitoring, and contract management of public contract and provides reliable market data for all sector stakeholders and audit function. All key areas and general framework of the public procurement process are regulated and the PPL and secondary legislation is accessible online – there is a very good access to information framework for public procurement in Georgia.

The 2013 EBRD assessment revealed that the Georgian institutional framework needs further development, as currently all procurement related functions, including operational central purchasing are handled by the SPA which may bring accusations of a conflict of interest between different institutional functions; the DRB should be reorganised into an independent review and remedies body, in particular. Tendering based on reverse auction is not suitable for all types of procurement, specifically complex projects. In order to minimise the number of direct contracts awarded in Georgia on the grounds that e-auction is not suitable for it a two stage system of tendering and request for proposals could be introduced into the Georgian eProcurement system.

The Georgian public procurement reform is close to achieving compliance with the 2012 WTO GPA standards for public procurement and further regulatory work should ensure that all phases of the procurement process are robustly regulated and reforms should promote economic development through higher supplier and contractor engagement.

The current PPL does not provide for an independent review and remedies for public procurement; the existing review procedure is simple and very efficient but does not guarantee independence from the regulatory authority as recommended by international best practice for reviewing complaints on public procurement. In addition, the accountability
and integrity safeguards should be further promoted, and direct contracting decreased in numbers and value per year. Also, the PPL could introduce a published code of ethics for public procurement officers.

The EBRD annual review of the public procurement sector in Georgia confirms that the reforms have been successful. Continued improvements in the public procurement regulatory framework have been observed since commencement of the reforms in 2009. As the EBRD assessment results reflect, the regulatory and institutional framework for public procurement has improved with respect to every indicator in the benchmark, (See charts 7 & 8). Georgia needs to take the last final step to join the WTO GPA. If reforms are finalised, Georgia will have one of the most modern public procurement systems, promoting fair competition, transparency and openness to international trade.

This is clearly an achievement of the Georgian government and a positive result of the political will to improve public sector purchasing and combine public procurement reform with wider fiscal reform of the public sector. In Georgia, modern purchasing techniques, such as eProcurement, have been systematically implemented into the general e-Government structure and provide an example of what can be achieved in terms of adopting modern efficiency instruments in the public procurement sector.

The Georgian institutional framework is not yet sufficiently robust, according to international standards and practices adopted for procurement procedures are not yet clearly to the standards of the 2012 WTO GPA in terms of submission deadlines, length of the standstill period and some regulatory gaps in the institutional framework. However, the overall development of the public procurement system in Georgia is impressive and if reform is continued may easily bring the Georgian PPL in full compliance with international best practice and guarantee Georgia successful negotiation of the WTO GPA accession.

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**Chart 7 - Georgia’s quality of public procurement legislation**

Note: The chart shows the score for the effectiveness of the national public procurement laws. The scores have been calculated on the basis of a questionnaire on legislation that is developed from the EBRD Core Principles for an Efficient Public Procurement Framework. Total scores are presented as a percentage, with 100 per cent representing the optimal score for each Core Principles benchmark indicator. The bigger the “web” the higher the quality of legislation.

Source: EBRD 2011 Public Procurement Assessment
**Telecommunications**

The key primary legislation is the Law on Electronic Communications of 2005 (amended up to 2011). To get a clear idea of regulation of the sector, however, this law must be must read in conjunction with the Law on Broadcasting and other multi-sector legislation that impacts the sector. Sector legislation is largely aligned with the main requirements of the European Union (EU) 2003 framework, including the important areas of regulatory independence, general authorisation, market analysis, designation of significant market power, imposition of remedies, enforcement, interconnection, consumer protection and management of scarce resources. Some aspects of the framework, however, are still not yet fully aligned, including universal service and rights of way (see Charts 5 and 6).
Chart 5 - Comparison of the legal framework for telecommunications in Georgia with international practice

Key: Extremities of the chart = International best practice
Note: The diagram shows the quality of the legal framework as benchmarked against international standards (European Union). The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the “web”, the closer the overall telecommunications legal framework of the country approximates these standards.
Source: EBRD 2012 Electronic Communications Comparative Assessment.

The conditions for full competition have been in place in Georgia for over 10 years, with the independent converged regulator, the Georgia National Communications Commission (GNCC) already using many best practices from the EU regulatory framework covering telecommunications, internet and broadcasting. Market entry is straightforward and most of the normally expected competitive safeguards are already in place. Notably, however, the incumbent fixed operator’s wholesale rates for infrastructure access are generally significantly above EU averages, restricting wholesale markets and prompting the larger alternative operators to rely on their own infrastructures. Smaller competitors have now appeared, using fixed wireless technologies to expand broadband coverage out to smaller towns and villages. Otherwise, imbalances in the mobile spectrum allocations have contributed to the restricted development of fully competitive conditions in the mobile market. Accordingly, GNCC needs to liberalise the spectrum further to promote investment, especially to meet the significant increase in broadband data traffic being experienced by all market players. Spectrum needs to be made technologically neutral, and re-farming of the existing GSM spectrum bands is required to remove the current competitive restrictions. The introduction of better conditions for national roaming and for the entry of virtual mobile operators would also stimulate the market.
Chart 6: Comparison of the overall legal/regulatory risk for telecommunications in Georgia with international practice

Key: Extremities of the chart = International best practice

Note: The diagram shows the quality of the legal framework as benchmarked against international standards (European Union). The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the “web”, the closer the overall telecommunications legal framework of the country approximates these standards.

Source: EBRD 2012 Electronic Communications Comparative Assessment.

The EBRD does not currently have direct investments in the sector in Georgia; however the presence of a strongly EU-reflective legal and regulatory framework makes the overall environment for the sector attractive for investment, promotes broader competitiveness across the economy and aids social development.

To support the evolution of policy and regulatory environment that best enables the significant new investment in infrastructure, EBRD’s Legal Transition Team continues to work with the Ministry for Economy and Sustainable Development and GNCC to support the modernisation of sector policy and enhanced effectiveness of regulatory implementation.

Significant new investment in infrastructure is required to meet the strong demand for fixed and mobile broadband services. The government still has to create a supportive policy framework to attract this investment, particularly in rural areas. GNCC needs to enforce better access and infrastructure sharing regulations to make future investments more efficient. Georgia is already the regional leader in applying modern electronic communications regulation. By taking the necessary steps to promote strong policy leadership and to improve competitive market safeguards, Georgia will maintain its position of low legal and regulatory risk for the next significant wave of broadband-led investments.
Private Sector Support

Access to finance

Applicable legislation in the sector includes the Civil Code of Georgia, dated 26 June 1997; the Law on Public Registry, dated 19 December 2008; and the Law on Payment Systems and Payment Services, dated 1 July 2012:

A modern secured transactions framework for taking pledges over movables was first introduced in 2005 by amending the Civil Code. The new provisions provided for flexible, efficient and modern legal means for the creation, perfection and enforcement of a pledge. Since then the Civil Code saw several amendments of the provisions for regulating the taking of both mortgages over immovable and pledges over movable property and rights (e.g. 2006, 2007 and 2008) with the last ones taking place in 2011 (9 March 2011 and 1 July 2011).

The law now allows for a general definition of collateral and of the secured debt (a credit line of a revolving loan can now be secured). Notarisation of the charge agreement is not required, but parties may find that they have an interest in executing the agreement as a notarial deed in order to benefit from expedient enforcement procedures. The amendments in 2011 allow parties to limit the right to pledge only to parts of movable things or rights (non-material property wealth). When the object of pledge is described generally as “all the movable assets of the pledge”, it is not necessary to describe these assets in the pledge agreement. The 2011 amendments also provide that the right to pledge automatically extends to the fulfilment of a pledged claim or insurance payment, even if such provision is not provided for by the parties in the agreement. The law also now regulates in detail the effects the processing and mixing of the pledged assets have on the pledgee’s rights.

Registration of the pledge is made in an electronic database at the Register operated by the National Agency for Public Registry (NAPR) regulated by the Ministry of Justice. The register is remotely accessible for authorised persons (such as notaries, banks and law firms). However, documents still need to be filed with the Registry and searching the register is not possible electronically. More than sixty territorial registration offices operate throughout the country under the NAPR, which perform activities defined by the NAPR statute and applicable legislation. Upon acquiring an enforcement certificate a pledgee can enforce the pledge out of court. The pledgee can even enforce his security right by obtaining title over the collateral (as opposed to selling it).

The Law on Payment Systems and Payment Services introduced the concept of financial collateral (or financial pledge), which entitles the creditor to preferential satisfaction of his claim to the extent secured by the financial collateral, ahead of all other secured and unsecured creditors. The Law applies to any type of financial collateral (pledge) agreement between specified group of legal entities pursuant to which the collateral is money or financial instruments issued in Georgia.

Taking mortgages over immovable property has also been modernised over time. A mortgage is legally created only upon registration with the NAPR. The Civil Code provisions allow a mortgage to secure a fluctuating amount of debt which covers types of financing like loan facilities, loans with a flexible interest rate or revolving loans. In order to register a mortgage the mortgage parties’ signatures need to be authenticated before a notary public or the parties must present themselves before the NAPR’s officer to sign the security instrument.

Relevance to EBRD operations: Georgia has undertaken serious reforms of the secured transactions system in the last decade and the result is well developed and modern legal framework for taking security interests. However, limited on-line access to the registered information and somewhat outdated and lengthy procedures for registration (necessity to present documents to the registrar) can still cause delays of the transactions and increase costs. This can be burdensome for the parties, particularly SMEs and therefore the modernisation of the system would be a welcome move.

Modernisation of the present registration regime aimed at removing limitations of the on-line access to the registered data and change towards the notification based system of registration would be a welcome move. The principal legislation regulating securities markets in Georgia is the Law on Securities Market, dated 24 December 1998 (as amended). Other applicable legislation includes, in particular, the Law of Georgia on Non-Bank Depository Institutions-Credit Unions, in force on 1 October 2002, regulating the activities of credit unions.

Capital Markets

The Georgian Financial Supervision Agency, established on 24 April 2008 under the Organic Law on National Bank, is the sole entity responsible for supervising the financial sector. It replaced both the National Security Commission and the State Supervisory Service of Insurance. The Agency is in charge of supervising the banking sector, securities markets and insurance sector, as well as issuing licences to and regulating financial institutions, including commercial banks.

The Georgian Stock Exchange (‘GSE’), designed and established with the help of USAID in 1999, is the only organised securities exchange in Georgia.
The legal framework seems to be appropriate in relation to the size and level of activities of the Georgian capital market; however, there is a need for improvement in the legal framework in relation to money markets, including repo transactions and derivatives.

As regards the Georgian money market, the National Bank of Georgia (‘NBG’) plays an active role in the Georgian domestic money market, in particular interbank lending, and develops currency policies through its monetary policy committee. In relation to applicable legal framework it is worth noting that in 2011 the Regulation on repo operations was repealed and at present no regulation exists that specifically addresses repo and reverse repo operations. Moreover, Georgian law does not have a clearly defined concept of netting and netting arrangements. The recently adopted law on Payment Systems and Services refers to the concept of netting, under this legislation close-out netting is viewed in the context of enforcement of financial collateral. The applicability of the law on Payment Systems and Services to over-the-counter derivative transactions documented by a master agreement seems to be questionable and certainly untested.

As regards the Georgian debt capital market, it is relatively small and illiquid. Financing is mostly done through banks and market participants do not seem very interested in alternatives to banking sector financing, e.g. issuance of corporate bonds – although, Georgian law provides for corporate bond issuance.

In terms of equity capital markets an interesting development was Order No. 170/01 of the President of the National Bank of Georgia, dated 28 December 2010 that sets out a list of stock exchanges that are qualified as “foreign recognized stock exchanges.” More specifically, the Order has finally explicitly set out a list of those stock exchanges, which by virtue of the Law of Georgia on Securities are to qualify as “foreign recognized stock exchanges”, and, therefore, securities admitted to such stock exchanges, should also be admitted for a trade on any Georgian securities trading platform, or for the purposes of public placement under Georgian jurisdiction, without a need to undergo complex formalities which are commonly attributable to public placement of shares under Georgian law. This is a very positive legal development for the Georgian equity capital market.

In the financial sector in Georgia, the EBRD focuses on expanding support to existing and new partner banks, as well as developing the non-bank financial sector with a specific focus on leasing, insurance and private pension schemes.

Georgia is currently aiming to strengthen its banking and monitoring system, re-energize bank lending, and keep the level of non-performing loans down.

In terms of main policy recommendations, it may be beneficial for the development of Georgian capital markets to clarify provisions related to netting arrangement, including close-out netting. This would increase confidence of international investors when entering into derivatives transactions. Moreover, regulations governing repo transactions should be developed by the NBG.

Overall, the Georgian financial sector has been heavily impacted by the dual shock of the armed conflict with Russia in 2008 and the global economic crisis; today, this sector is showing some improvement, however, the legal framework would benefit from more clarity and certainty.

**Corporate governance**

The Law on Entrepreneurs, adopted in 1994, regulates the formation, organisation and dissolution of joint stock companies, including banks. The law sets the basics for corporate governance, describing the governing bodies of companies and their responsibilities. The law allows companies to choose between one and two tier governance systems up to the threshold of 100 shareholders. However, this option is not available to banks, which must be organised under a two-tier system according to the Law on Activity of Commercial Banks.

The Law on Activity of Commercial Banks was adopted in 1996 and has been heavily amended since then. It regulates the activity of banks, all aspects of banks licensing and structure of banks. The law requires a two-tier governance system for banks. The law contains basic requirements for members of the supervisory board, management and audit committee.

The Corporate Governance Code for Commercial Banks was developed by the Association of Banks and adopted in 2009. It includes a set of recommendations on shareholders rights, supervisory and management boards, corporate secretary, internal control and risk management, information disclosure and transparency, conflict of interests and corporate governance of holdings. Its recommendations are meant to be applied under the so called “comply or explain” mechanism, according to which banks are required to comply with the proposed recommendations or to explain the reasons for such non-compliance. A number of banks have signed up to the code but none has so far published any “comply or explain” statement, or otherwise published any reports in relation to the code.

The 2007 EBRD assessment on corporate governance showed Georgia being in “very low compliance” with the OECD Principles of Corporate Governance, showing a number of shortcomings in all areas under consideration (see Chart 11).
In an attempt to deregulate the market and provide market participants with the necessary flexibility, the legislator has left the functions and responsibilities of the supervisory board (in the mandatory two-tier structure) primarily at the discretion of companies and banks. As a consequence, the law does not detail the distribution of authority and responsibility between the supervisory board and the management board. This is of particular concern for banks, where the board is not clearly entrusted with the authority to approve the bank’s strategy, risk strategy and risk appetite, annual budget and to monitor their implementation. Further, the framework does not provide guidance on the composition of the supervisory board, its committees and their role. Similarly, the law requires banks to set up audit committees, but does not establish any requirements regarding their composition. As a result, in some banks the audit committee is not a board committee but a separate body, which may include outside members, who have no duties of loyalty and care towards the bank. Moreover, audit committees are not required to include independent directors.

Chart 11 – Quality of the Corporate Governance Legislative Framework in Georgia

Note: the extremity of each axis represents an ideal score, that is, legislation fully in line with the OECD Principles of Corporate Governance; the fuller the ‘web’, the better the quality of the legislative framework.

Source: EBRD Corporate Governance Assessment 2007

The 2007 EBRD assessment on corporate governance has shown a number of deficiencies in the implementation of the corporate governance framework in Georgia (see Chart 12). The banking law and regulations do not require that (at least) systemically important banks disclose information about bank management bodies, governance structure, risk management and ownership structure. Although the Corporate Governance Code contains a comprehensive section on information disclosure and transparency, the Code is merely declarative in nature and bears no weight on bank practices. The “comply or explain” approach foreseen by the Code remains on paper and banks do not report on their implementation of the Code’s recommendations. The issues outlined above are relevant for the EBRD direct investment in companies and banks in the country. No investee companies’ corporate governance related suits have been reported.
Chart 12 – How the corporate governance framework works in practice in Georgia

Note: the extremity of each axis represents an ideal score: the fuller the ‘web’, the more effective the corporate governance framework.
Source: EBRD Corporate Governance Assessment 2007

As for the main policy recommendations, the Law on Entrepreneurs and/or banking regulation should guide the distribution of powers and responsibilities between the board and the management. In banks, strategic decisions (e.g., approval of strategy, budget and risk appetite) should belong to the supervisory board, while operational matters should be best delegated to the management board.

In banks, banking regulations should include appropriate “fit and proper” criteria for supervisory board members and require that supervisory boards include a sufficient number of well qualified, independent members. They should also serve in board committees, which should be composed only of “board” members.

The Corporate Governance Code for Commercial Banks should be given proper implementation, by requiring banks to “comply or explain” the Code’s implementation.

Georgia has enacted the main tools for regulating corporate governance but it has missed detailing some of the key issues in the governance of companies and banks. The enactment of the corporate governance of commercial banks is a step in the right direction, provided that the code’s recommendations do not merely remain on paper.

Insolvency

The principal legislation governing the law on insolvency in Georgia is the Law on Insolvency Proceedings (the "Law on Insolvency") dated 29 June 2012, which applies to corporate entities and sole traders. It can be initiated by debtors that are cash-flow insolvent or that have encountered the threat of imminent insolvency. Certain new provisions in the Law on Insolvency, which relate to the application of new electronic insolvency case management systems, will only come into force from 1 January 2013.

The Law on Insolvency expressly excludes consumers, public law entities, banks and insurance companies from its application. Pursuant to a regulation on announcing a commercial bank insolvent and bankrupt approved under Decree No. 119 May 23, 2003 by the President of the National Bank of Georgia, only the National Bank of Georgia may declare a bank to be insolvent. Under the new 2012 Law on Insolvency, the National Bank of Georgia has jurisdiction to file insolvency applications before the court in respect of “qualified credit institutions”, namely deposit-taking and loan-making institutions.
The EBRD’s 2009 insolvency sector assessment (the “Assessment”) highlighted a number of weaknesses in Georgian insolvency laws in existence at the time of the Assessment, including absence of a full interim moratorium upon a debtor’s entry into insolvency proceedings and inadequate provisions governing reorganisation in insolvency and avoidance of transactions entered into by the debtor prior to insolvency (see Chart 13).

Chart 13 – Quality of insolvency legislation in Georgia

Note: the extremity of each axis represents an ideal score, that is, legislation fully in line with international standards such as the World Bank’s Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group’s “Legislative Guidelines for Insolvency Law”; and others. The fuller the ‘web’, the better the quality of the legislative framework.

Source: EBRD Insolvency Sector Assessment 2009

Following the date of the Assessment, Georgia has introduced a number of reforms to its insolvency laws, mainly aimed at improving the efficiency of its insolvency processes. In 2011, Georgia made changes to streamline the regulation of auction sales in insolvency. In 2012, the newly-adopted Law on Insolvency made significant changes to the administration and management of insolvency cases to enable all cases to be managed via electronic systems and legislate for the publication and sharing of information between parties in electronic form. The new electronic systems require all court decisions taken in insolvency proceedings to be recorded within two days. Amendments introduced in 2012 have also introduced further details with respect to the appeals process and the timeframe required.

Many of the issues highlighted in the EBRD’s Assessment remain however unaddressed. Although the Law on Insolvency contains a moratorium on all enforcement measures following issuance by the court of a ruling accepting the insolvency application, it does not apply more widely to a general suspension of all court proceedings against the debtor. Provisions governing reorganisation plans in insolvency fail to contain any minimum protective requirements for a reorganisation plan, such as for dissenting creditors to receive at least as much in a reorganisation as they would in a liquidation. The avoidance provisions in the Law on Insolvency remain limited in scope and rather unclear. At present these set a suspect period of six months and do not extend the suspect period for transactions between the debtor and related parties, as is best practice in many insolvency law systems.

Furthermore, at present failure by a creditor to file a claim within the requisite time period will result in the creditor falling to the bottom of the list of priorities, subordinated to all other unsecured creditors. In other insolvency law systems there is a “catch” up principle whereby creditors who fail to submit their
claim in time may catch up and rank equally alongside other creditors in respect of any future distributions. Finally, the existing grounds for creditors petitioning for the opening of the insolvency process, envisaging circumstances where one, two or three creditors make the petition, is complicated and could be streamlined.

There is some specialisation in the court system for insolvency in that insolvency cases may only be heard by a court in Tbilisi and Kutaisi. Furthermore the Law on Insolvency attempts to set a number of deadlines for the insolvency process, such as the requirement for insolvency proceedings initiated by the debtor to be concluded within 207 days and creditor-initiated proceedings to be concluded within 225 days. It is not clear whether these deadlines are respected in practice.

Finally, we understand that, under the existing Law on Insolvency, the Trustee responsible for managing the debtor's business during preliminary insolvency proceedings prior to (and thereafter in the absence of) the appointment of a bankruptcy manager and for determining the claims admitted in the insolvency is the National Bureau of Enforcement, a government bureau operating under the Ministry of Justice. The National Bureau of Enforcement also plays a role in the auction process for sale of insolvency assets. A separate corporate body, the "Reconciliatory Board", assesses and decides on the insolvency of the debtor. The Ministry of Justice may consider reducing the number of parties active in the insolvency, in order to improve efficiency.

Insolvency is an area of cross-sector relevance for any EBRD operations in Georgia, as it may affect any form of investment, whether made by way of equity or loan.

As for current or proposed reforms, the Law on Insolvency is very recent. We are not aware of any future legislative initiatives, however we note that the Law on Insolvency as regards priorities of payment of creditors in an insolvency has changed a number of times in recent years and may change still further.

With respect to main policy recommendations: Whereas progress has been achieved by the 2012 reform, there are still a number of important weaknesses in the system that should be addressed.

Overall, the Law on Insolvency contains the mechanisms for both liquidation and reorganisation of an insolvent debtor; however it continues to be weak in certain areas as regards creditors' rights and protection of the insolvency estate. The introduction of new electronic systems should nevertheless assist with making the insolvency process more efficient and transparent for creditors.