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DEVELOPMENT OF TOURISM INFRASTRUCTURE

LEGAL FRAMEWORK FOR PRIVATE PARTICIPATION

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EXECUTIVE SUMMARY

This report (hereinafter the “Report”) examines in detail the legal framework for private participation in development of tourism infrastructure in Georgia. Particular attention is paid to concession agreements and similar mechanisms, which may be employed by the State for the purpose of attracting private investments in the tourism industry.

At the outset, it needs to be noted that the body of legislation on tourism is largely undeveloped in Georgia. Tourism industry related laws, rules and regulations are outdated and contain many gaps and contradictory provisions, which need to be streamlined in order to create more effective legal framework, not only for private participation in development of tourism infrastructure, but also for the creation of a proper management policy for the entire tourism sector.

For the purposes of identifying the relevant legal mechanisms to be employed by the State for attracting private investments in tourism infrastructure, this report will closely examine the relevant laws and regulations on privatization as well as other related legislation which provide for granting of concessions, including lease, right of usufruct, right of build, etc.

In general terms, tourism infrastructure consists of main and additional components. Accommodation facilities, recreational facilities and many others come under the ambit of main tourism infrastructure. On the other hand, roads, railways, airports, electricity/water supply and the like represent additional tourism infrastructure.

From a legal point of view, Georgian legislation does not provide for any special treatment of private investments in the tourism industry. However, creation of a developed tourist infrastructure may require certain specific rights to be granted to private investors.

Currently, the principle legal act related to tourism in Georgia is the Law of Georgia on Tourism and Resorts of 6 March 1997 (hereinafter the “Law on Tourism”). This law was intended to set up the basic principles and regulations of the entire tourism industry. However, as already stated above, the law is outdated and needs substantial revision.

In Georgia there is an imminent need for private participation in development of tourism infrastructure. From a legal point of view, Georgian law in principle does not differentiate private investments in tourism from those in other industries, nor does there exist any special forms to

obtain rights to land or other property to be used specifically for development of tourism infrastructure.

RIGHTS TO LAND AND IMMOVABLE PROPERTY

As already stated above, tourism infrastructure mainly consists of resort and recreational facilities. Therefore, any private investor willing to create such facilities either needs to (a) acquire the land or other immovable property into ownership or (b) obtain certain other rights on such land and/or property.

A. Right of Ownership

The property (including land) to be used for implementation of tourism-related infrastructural projects may be directly acquired from private owners or privatized from the State by using any of the privatization options.¹ As stated above, the relevant Georgian legislation does not provide for any specific treatment of land or other property acquisitions intended for creation of tourism infrastructure. However, the law establishes certain limitations with respect to acquisition of certain types of property. One of these limitations applies to recreational lands and the lands of forest resource funds. Usually such recreational lands are most attractive for implementation of tourism-related projects. In this respect, the Law of Georgia on Privatization of State-owned Agricultural Land (article 2) directly prohibits privatization of recreational lands and agricultural forest resources. However, the law also provides for an exception from this rule by stating that such lands may be privatized only for the purposes of creation of large-scale recreational and resort facilities. Only the Government of Georgia has the authority to consent to such privatization.

Relevant Georgian legislation also lists additional types of properties which may be attractive for private investors in the tourism industry. Such property includes: forest resources, state preserves, national parks, lands of natural monuments, protected territories, sea shores and beaches, etc. These are considered as exclusive property of the State and are not subject to privatization.

Moreover, properties and lands representing part of the cultural heritage of Georgia are also not subject to privatization. However, under the relevant legislation, numerous exceptions apply to privatization of objects of art having cultural and historical importance and buildings used for these purposes. Such objects and buildings may be privatized only with the consent of the Ministry of

¹ Under current Georgian legislation these privatization options are direct sale and auction.

Culture, Monuments Protection and Sports of Georgia, provided that they will continue to be properly preserved.

B. Other Rights

Irrespective of the above restriction on privatization, relevant Georgian legislation provides for certain other rights (other than the right of ownership) private investors may obtain on those properties which are not subject to privatization and may be used for the development of tourism infrastructure. These rights include: (i) lease (ii) right of usufruct and (iii) right to build.

(i) Lease

Lease is defined in articles 581-591 of Georgian Civil Code of 26 June 1997, as amended (hereinafter – the “Civil Code”). Under the lease, the leaser is obliged to transfer to the lessee certain property (including land) in temporary use and to secure the possibility of obtaining the fruits of such property within the period of the lease provided that they have been obtained as a result of the proper management of the leased property. The lessee is obliged to pay to the lessor the agreed upon rent. Additionally, right of lease is subject to registration in the public register. Moreover, if a land plot is rented with inventory, the lessee is liable for the maintenance and care of each part of the inventory.

It is also important to note that if the lease is concluded for the term of more than 10 years, under the Civil Code any party may terminate the lease without just cause after expiration of the initial 10 years term, provided that the lease is concluded for more than 10 years.

(ii) Usufruct

The civil code defines the legal nature of usufruct (articles 242-246) by providing that an immovable object (including land) may be transferred to the use of another person in such a manner as to grant him the right to use this object as if he were the owner and to exclude third parties from its use; unlike the owner, however, the usufructuary has no right to alienate, mortgage or transfer the object by inheritance (a usufruct). The leasing of such an object requires the consent of the owner. After the usufruct is extinguished, the owner shall substitute the holder of the usufruct in the existing relations of lease or rental if any (made with third parties).

The right of usufruct does not authorize the holder of such a right to construct any fixtures on the land transferred to him under such right. However, any temporary constructions and/or installations

are usually allowed. Right of usufructs is also subject to mandatory registration in the public register.

(iii) Right to Build

Under the Civil Code (article 233-241), a land plot may be transferred to another person for a fixed-term enjoyment in such a way as to entitle him to construct on the land plot or thereunder any construction or installation (the fixtures). The holder of the right to build is authorized to transfer, assign, lend or lease this right to any third party. Any building, construction or installation (fixture) constructed on the land plot becomes an inseparable part of the right to build.

The right to build may be granted for the term of up to 59 years and in the case that the holder of the right to build is obliged to pay the agreed upon fee during the agreed upon term, upon expiration of the right to build the owner of the land plot shall either reimburse at least 2/3 of the value of the building constructed on the land plot or extend the right to build for the lifetime of the building.

RESTRICTIONS RELATED TO GRANTING OF OTHER RIGHTS

As already discussed above, certain state property may not be privatized; instead private investors may obtain other rights, such as lease, right of usufruct and the right to build. However, the relevant body of legislation also limits or restricts to a substantial extent the possibility of granting other rights on certain types of properties. Such limitations specifically concern protected territories.

In this respect article 12 of the Law of Georgia on the System of Protected Territories of 7 March 1996 as amended stipulates that the use of natural resources in the territories of state preserves, national parks, lands of natural monuments and wildlife preserves may not be granted to private investors. However, certain exceptions apply which extend to the zones of traditional use of national parks and, in exceptional cases, to specific parts of wildlife preserves.

In general any activity, including fishing, hunting, commercial, construction, transportation, etc., within the protected territories are heavily regulated by the Law on Protected Territories and relevant legislative and sub-legislative acts.

Georgian law does not give a clear answer to the question of whether protected territories or any of their parts may be leased or transferred with the right of usufruct to private investors. Thus, taking

into consideration the legal nature of lease and usufruct, one may take the view that the above article 12 prohibits leases or usufructs on protected territories except for specific zones of traditional use of national parks and specific parts of wildlife preserves. However, from the practical point of view there shall be no obstacle to leasing or granting of other rights on certain parts of the protected territories provided that the natural resources of such territories are not used and all other limitations related to activities within the protected territories are in full compliance. As an example of one such use is that a private investor may wish to organize tourist paths within the boundaries of protected territories. Creation of such paths may not require the use of natural resources. Provided that all the restrictions and limitations related to the activities allowed within the protected territories are fully complied with, granting of a lease on such tourist paths to a private investor should not in principle be prohibited.

As for the right to build, granting of such a right depends on the type of the protected territory in question and the activities allowed within the respective boundaries of such territories.

RULES AND PROCEDURES FOR OBTAINING OTHER RIGHTS ON CERTAIN STATE-OWNED PROPERTIES

As already discussed above, objects of cultural heritage, including their lands or any buildings may be privatized with the consent of the Ministry of Culture, Monuments Protection and Sports, provided that such objects of cultural heritage are subsequently properly preserved. Under the Law of Georgia on Cultural Heritage of 8 May 2007, such objects of cultural heritage may, *inter alia*, represent buildings and the lands under them. Article 32 of this law provides, among others, that such buildings (structures, monuments) may be either privatized with the consent of the Ministry of Culture, Monuments Protection and Sports, or transferred with the right of use to a private investor. Such right of use, *inter alia*, implies the lease, usufruct and right to build.

Law of Georgia on Transfer of State-owned Buildings with the Right of Use of 14 April 2006, as amended, as well as the Regulation adopted by the Government of Georgia on Transferring State-owned Buildings with the Right of Use of 12 June 2006, as amended, establish the relevant rules and procedures to be applied to transfer the right of use of state-owned buildings and their land plots. Under the law and relevant regulations, private investors may obtain lease, right of usufruct or the right to build on buildings and their land plots. Monuments of cultural heritage also fall within the definition of such buildings.

Under the law, the right of use of the buildings/constructions, including monuments of cultural heritage and lands under them described above may be acquired by using two options – (a) auction and (b) competitive bidding. Furthermore, in exceptional cases and provided that the Government of Georgia gives its consent by issuing the appropriate ordinance, such right of use may be obtained directly without auction or competitive selection; however, the law does not provide for any procedure in this respect.

A. Auction

The procedures for auction are similar to those applied to privatization of state-owned property. The announcement of auction is made in the official gazette and other printed media. In all cases the announcement of auction is published at least 30 days prior to actual auction date.

After the auction has been properly announced, any interested party may inspect the property to be transferred with the right of use. For the purposes of carrying out of the auction procedures, the appropriate state authority (the Ministry of Economic Development of Georgia) sets up the auction commission, which consists of a chairperson, registrar, secretary and other members.

The auction takes place on thirtieth day from the relevant announcement date. Applications can be received on the date of the auction but only until such hours as fixed by the auction commission. Any interested party may register for participation in the auction provided that such an interested party submits the following documents to the registrar: (i) the application, which includes the information on the applicant. In case of a conditional auction, the applicant shall also express in writing readiness to assume and fully comply with such conditions; (ii) documents certifying payment of the deposit (if any) and the participant's ticket; (iii) copy of the relevant identification card/passport of an applicant or, if such applicant is a legal person – copies of the relevant incorporation documents and the recent excerpt from the company register; and (iv) the relevant power of attorney duly certified by a notary, in case the applicant is acting as an agent of another person.

If all the above documents are properly submitted, the registrar of the auction commission will make the appropriate record in the relevant book of participants and issue the participant's ticket. Upon issuance of the participant's ticket, the applicant acquires the status of an auction participant. However, if any of the above documents are incomplete, the registrar of the auction commission will refuse to register the applicant.

On the date of the auction, but before the actual auction commences, the participant enters the auction mart and presents his participant's ticket to the registrar. The latter issues a small auction board with the same number as on the participant's ticket.

The auction commences with the auctioneer announcing the initial price of the rent/fee to be paid for the right of use of the property and the bidding step. Any participant wishing to increase the amount with the bidding step shall raise his auction board. The auctioneer will pronounce the initial amount plus the bidding step. When the auctioneer pronounces the last offered amount three times and knocks the hammer, the property is deemed to be transferred with the right of use to the highest bidder and the auction closes. Subsequently, the relevant protocol is drawn up and signed by the chairperson of the auction commission and the winner. If the winner refuses to sign the auction protocol, he will be deprived of the status of the winner and the deposit (if any) will not be returned. Within the following 7 days the auction commission will prepare the auction report, which is the basis for returning the deposits (if any) paid by unsuccessful participants. However, in the case that none of the participants present at the auction make a bid, the commission will draw up the protocol for an abandoned auction and the deposits will not be returned.

Upon closing the auction and drawing up of the auction protocol, the relevant agreement on the transfer of the property with the relevant right of use will be concluded.

B. Competitive Bidding

Acquisition of the right of use of the state-owned buildings/constructions including monuments of cultural heritage via competitive-bidding used to be regulated by a sub-legislative act, which was applied to privatization of state property. However, since July 2007 competitive-bidding procedures have been abolished by the Law on Privatization. Therefore, it is not currently clear what procedures and rules should be applied with respect to acquisition of the right of use of the above property via competitive bidding.

C. Agreement on Transferring State-owned Property (Buildings) with the Right of Use

The Law on Transfer of State-owned Buildings with the Right of Use, as amended, as well as the Regulation adopted by the Government of Georgia on Transferring State-owned Buildings with the Right of Use, provide for some specific requirements to be applied to the agreements on transferring the right of use for state-owned buildings (property). Such agreements need to be

entered into between the Ministry of Economic Development (or its territorial sub-division) and the winner of the auction within at least 3 months from the date the auction results are confirmed.

Article 4 of the Law and Article 8 of the Regulation provide that the agreement on transferring state-owned property (buildings) with the right of use shall include at least the following: (i) name of the property and their location (address); (ii) term and duration of the agreement (except in the case of usufruct for an indefinite period of time) (iii) details of delivery and acceptance of the property; (iv) the amount of rent/fee; (v) obligation of the parties to modify any contractual term within one month in case of any changes in the relevant legislative or sub-legislative acts in order to ensure compliance of the agreement with recent legislative changes; (vi) area of the land plot where the property is located/fixed; (vii) rights and obligations of the parties with respect to subsequent use of the property; (viii) terms related to liability of the parties in case of non-compliance with the requirements of law or breach of contract.

In case a state-owned building (property) is transferred with rent-free usufruct, such holder of the right may not transfer to a third party the same rights of usufruct. However, in case of lease the lessee may pledge his right of lease with the consent of the Ministry of Economic Development.

One more point to address is that the Ministry has the right to terminate the lease or usufruct, as the case may be, if the lessee inflicts any substantial damages to the property under lease/usufruct or does not pay the rent for the consecutive three months.

GOVERNMENT PROGRAM TO ENCOURAGE PRIVATE INVESTMENTS IN THE TOURISM INDUSTRY

In 2007 the Government of Georgia has taken positive steps towards encouraging private investors (small and medium sized enterprises) to take an active part in development of tourism infrastructure in Georgia. In this respect, the Program on Employment through Development of Small and Medium Enterprises has been initiated and adopted by the Ordinance of the Government of Georgia No. 110 of 30 May 2007.

Under the ordinance, Program beneficiaries are small and medium sized enterprises who are the members of the tourism industry or intend to start their business activities in this field.

Based on the above program, the State has provided one of the commercial banks of Georgia (Joint Stock Company Pro-credit Bank) with a credit facility of GEL 5 million, applying an extremely low

annual interest rate (currently 2%). Under the ordinance, the bank is required to provide small and medium sized enterprises and start-ups with targeted loans intended for development of tourist infrastructure and for the facilitation of tourism-related business activities. The Ordinance provides that the annual interest rate which the bank may charge is 12%, which is lower than the current market interest rates and gives incentive to small and medium sized enterprises to invest in the development of tourist infrastructure.

Even though the amount of credit available under the program is not large enough to positively affect the entire tourism industry, it goes without saying that such initiative on the part of the government is a useful tool for facilitation of tourism industry development, as well as for the creation of additional tourist infrastructure.

CONCLUSION

As discussed above, the legislative basis of private participation in tourism infrastructure development in Georgia has not been significantly developed. The law does not provide for any special treatment of private investments in the tourism industry, nor does it specifically regulate questions related to obtaining ownership or other rights on property for projects relating to tourism infrastructure.

Irrespective of the aforesaid, Georgian law in general recognizes certain rights to land and other property which may be obtained from the state. Such rights include lease, right of usufruct and the right to build. Each of these rights gives the opportunity to private participants in the tourism industry to invest in and develop tourist infrastructure.

It goes without saying that the legislative basis of the entire tourism industry needs substantial revision and reconsideration in order to create a more liberal and incentive-based legal framework. This process is already underway and recent governmental initiatives, such as the provision of low-cost financial resources to small and medium sized enterprises involved in tourism industry, is a good example of such developments.