

8-1-1993

New Foreign Investment Regimes of Russia and other Republics of the Former U.S.S.R.: A Legislative Analysis and Historical Perspective

William G. Frenkel

Michael Y. Sukham

Follow this and additional works at: <http://lawdigitalcommons.bc.edu/iclr>

 Part of the [Comparative and Foreign Law Commons](#), [Legal History Commons](#), and the [Legislation Commons](#)

Recommended Citation

William G. Frenkel & Michael Y. Sukham, *New Foreign Investment Regimes of Russia and other Republics of the Former U.S.S.R.: A Legislative Analysis and Historical Perspective*, 16 B.C. Int'l & Comp. L. Rev. 321 (1993), <http://lawdigitalcommons.bc.edu/iclr/vol16/iss2/5>

This Article is brought to you for free and open access by the Law Journals at Digital Commons @ Boston College Law School. It has been accepted for inclusion in Boston College International and Comparative Law Review by an authorized editor of Digital Commons @ Boston College Law School. For more information, please contact nick.szydowski@bc.edu.

New Foreign Investment Regimes of Russia and other Republics of the Former U.S.S.R.: A Legislative Analysis and Historical Perspective†

William G. Frenkel,*
Michael Y. Sukhman**

*I cannot forecast to you the action of Russia. It is a riddle wrapped in a
mystery inside an enigma.*

Sir Winston Churchill
Radio broadcast, October 1, 1939

INTRODUCTION

For most of its existence, the Soviet Union operated in a closed economy with relatively few economic ties to the outside world. The Soviet command economy was built on the Marxist-Leninist principles of central planning and state ownership of property and, as such, could not accommodate foreign investment from free market economies. After a brief flirtation with limited foreign investment and private enterprise in the early twenties, during the so-called New Economic Policy or NEP,¹ no direct foreign investment² in the

† Copyright © 1993, William G. Frenkel, Michael Y. Sukhman

* William G. Frenkel (J.D. cum laude, New York Law School) is an associate attorney with Skadden, Arps, Slate, Meagher & Flom in New York and Moscow, who specializes in international corporate and foreign trade and investment matters with a particular emphasis on eastern Europe and the former Soviet Union.

**Michael Sukhman (A.B. Economics, Harvard College) is a candidate for a J.D. degree at the Benjamin N. Cardozo School of Law in New York.

¹ NEP is thought to have lasted from 1921 to 1928 and encompassed, *inter alia*, the practice of granting concessions for mining and manufacturing to foreign companies, establishing mixed-ownership joint stock companies and a partial restoration of foreign enterprise within the Soviet Russia as a temporary means to reverse the economic crisis of the time. In 1925 about 160 mixed-ownership companies existed, in 12 of which foreign companies were involved as participants, providing approximately 20 percent of the companies' capital. See KAJ HOBER, JOINT VENTURES IN THE SOVIET UNION § IV.A(1) (1989). For an economist's analysis of NEP, see generally V.N. Bandera, *The New Economic Policy (NEP) as an Economic System*, 71 J. OF POL. ECONOMY (1963) and ALEC NOVE, AN ECONOMIC HISTORY OF THE USSR (1969). A sociological survey of NEP is vividly presented in Alan M. Ball, *NEP's Second Wind: The New Trade Practice*, in 37 SOVIET STUDIES 371-85 (1985).

U.S.S.R. was legally possible until 1987.³ The demise of NEP signified an end to foreign equity investment in Russia, although other methods of East-West economic cooperation continued to arise from time to time.⁴

The Soviet economic and legal system also created a formidable obstacle to foreign investors from capitalist countries. In the Soviet version of a command economy, private ownership of property was limited to personal property, and business enterprises could only exist in the form of state-owned companies. Thus, investment in the U.S.S.R. before the late 1980s was highly unattractive to western business.

The vastness of the former Soviet Union's territory and its formidable natural resources insured that the needs of Soviet manufacturing, construction, and energy-producing industries were largely met by domestic suppliers and the Soviet Union's Council for Mutual Economic Assistance (COMECON or CMEA)⁵ partners. The Soviet economy, however, with its emphasis on heavy industries and military production, produced too few consumer goods to meet the domestic demands, let alone to export its products abroad. Furthermore, the inferior quality of Soviet manufacturing substantially restricted the market for Soviet exports. Thus, the Soviet Union was primarily limited to exports of energy and fuels, raw materials, natural resources, and crude industrial output to the West, and military hardware, heavy machinery, and aerospace products to its

² Direct foreign investment is commonly defined as a transaction in which an enterprise creates or acquires its own establishment—a subsidiary or a branch—in a foreign jurisdiction. See THOMAS F. CLASEN, *FOREIGN TRADE AND INVESTMENT: A LEGAL GUIDE* 191 (2d ed. 1990).

³ For the first time since the late 1920s, the Soviet government passed the enactment authorizing the creation and operation of joint ventures among western and Soviet firms in January of 1987. See Decree No. 49 of the U.S.S.R. Council of Ministers On the Establishment in the Territory of the U.S.S.R. and the Operation of Joint Enterprises with the Participation of Soviet Organizations and Firms from Capitalist and Developing Countries, SP SSSR, No. 49, Jan. 13, 1987, translated in HOBER, *supra* note 1, § A.3(3) [hereinafter Decree No. 49].

⁴ See Andrew McKay, *Foreign Enterprise in Russian and Soviet Industry: A Long Term Perspective*, in 48 *BUSINESS HISTORY REVIEW* 350–54 (1974). For a detailed discussion of East-West non-equity economic cooperation in the Soviet Union from the 1930s to the 1970s (including contractual joint ventures), see generally James F. Pedersen, *Joint Ventures in the Soviet Union, A Legal and Economic Perspective*, 16 *HARV. INT'L L. J.* 390 (1975) and Albert Kiralfy, *The Union of Soviet Socialist Republics*, in *EAST-WEST BUSINESS TRANSACTIONS* 338 (R. Starr ed., 1974).

⁵ Members of COMECON were Bulgaria, Cuba, Czechoslovakia, German Democratic Republic, Hungary, Poland, Romania, Mongolia, and U.S.S.R. See MICHAEL KASER, *COMECON, INTEGRATION PROBLEMS OF PLANNED ECONOMIES* 1–10 (2d ed. 1967); see also PAUL R. GREGORY & ROBERT C. STUART, *SOVIET ECONOMIC STRUCTURE AND PERFORMANCE* 293–95 (3d ed. 1986); see generally FRANKLYN D. HOLZMAN, *INTERNATIONAL TRADE UNDER COMMUNISM: POLITICS AND ECONOMICS* (1976).

client states in the Third World.⁶ This limited export capacity, together with occasional imports of grain and other agricultural commodities, industrial equipment, technology, and some consumer goods, defined the boundaries of commercial interaction between the Soviet Union and the outside world.

The Soviet economy was closed to international commerce primarily for political reasons. Marxist economic principles were placed in competition with the methods of capitalism. A popular slogan over the years was "to catch and overtake," meaning to bypass the United States in industrial might. Frequently, favorable comparisons between Soviet and U.S. industrial output indicators—such as production of steel and cement—appeared in the Soviet press largely for purposes of propaganda. These statistics were highly misleading or simply inaccurate and served to distract the Soviet consumer from the hardships of daily life, which included shortages of essential items and the shoddy quality of available goods.

In the cold war atmosphere of economic and political rivalry, international trade, investment, and economic cooperation with the U.S.S.R. were primarily reserved for other countries of the Communist block. Rather unexpectedly, several major breakthroughs drastically altered this condition. With the advent of "perestroika"⁷ under Mikhail Gorbachev in the mid-eighties, the end of the Cold War, and the dissolution of the Warsaw Pact and COMECON, global international economic cooperation became the order of the day.

Soviet leaders came to realize and accept that the interests of their country would be served by greater involvement of the Soviet Union in the growing globalization of the world economy. Foreign participation in the Soviet economy was seen as an essential element in the country's revitalization and the transition from a centrally planned economy to a market economy. Western companies, which had long seen lucrative opportunities in entering a commercially

⁶ These included, among many others, Cuba, Vietnam, and North Korea and were often made for the reasons of political strategy rather than commercial considerations. See Marshal I. Goldman, *Changing Role of Raw Materials Exports and Soviet Foreign Trade*, in U.S. Congress, Joint Economic Committee, 1 SOVIET ECONOMY IN A TIME OF CHANGE 263–99 (1979).

⁷ Perestroika is generally described as "restructuring" of the Soviet economy, instituted in response to the economic stagnation of the 1970's in order to stimulate economic growth and raise the Soviet standard of living. See generally Harold E. Rogers, Jr., *Glasnost and Perestroika: An Evaluation of the Gorbachev Revolution and Its Opportunities for the West*, 16 DENV. J. INT'L L. & POL'Y 209, 210 (1988); PADMA DESAI, PERESTROIKA IN PERSPECTIVE: THE DESIGN AND DILEMMAS OF SOVIET REFORM (1989). For Mr. Gorbachev's own account of the political and economic phenomenon he helped to bring about, see MIKHAIL S. GORBACHEV, PERESTROIKA: NEW THINKING FOR OUR COUNTRY AND THE WORLD (1987).

unexplored market the size of the Soviet Union, displayed great interest in the new opening of the Soviet economy.

Unfortunately, the first phase of the foreign investment reform, from 1987 to 1990, resulted in a disappointingly low level of new western investment.⁸ Despite the authorization of joint ventures with western partners in January of 1987,⁹ the joint ventures had a slow start due to the turtle-like pace of dismantling the state enterprise apparatus and state planning system. Government bureaucracy and corruption appeared to be staggering; joint ventures' employees and suppliers were unmanageable; and legal regulation of the joint ventures' management and operations was too restrictive.¹⁰ Operations in the traditional Soviet economy proved to be a tactical nightmare for most of the western companies. The few successful western companies either had special relationships with the Soviet foreign trade apparatus dating to the 1960s or masterfully exploited the inefficiencies of the Soviet foreign trade apparatus to their advantage. In contrast, many relative newcomers looked at their presence in the Soviet Union as an on-going long-term investment.¹¹ Many other U.S., Canadian, and western European companies, large and small, had failed in their trade and investment overtures to the Soviets in the past; however, a record of their fiascos barely exists

⁸ One commentator reported that during this period, approximately 2,300 joint ventures with foreign companies were registered by the Soviet authorities; however, less than 20 percent of these joint ventures were actually operating and a very small percentage of these ventures were profitable. See Brian L. Zimble, *Soviet Foreign Investment Laws and Practices, 1987-1990: A Practitioner's Perspective*, 4 TRANSNAT'L LAW. 85, 90 (1991).

⁹ See Decree No. 49, *supra* note 3.

¹⁰ See generally Timothy L. Felker, Jr., *Perestroika and Western Direct Investment: The Task of Integrating a Western Company into the Changing Soviet Economy*, 12 U. PA. J. INT'L BUS. L. 219 (1991).

¹¹ Such companies as PepsiCo, Occidental Petroleum, and Archer Daniels Midland probably present an exception to this rule in that they have succeeded in forging strong and profitable ties with the Soviet government due to their previous efforts to establish trade ties cultivated over a period of several decades. Up until the 1980s, these multinationals derived substantial revenue from the Soviet operations, though their transactions did not qualify as direct foreign investment, but rather were trade, countertrade, and transfer of technology transactions. See TERRY L. HEYNS, *AMERICAN AND SOVIET RELATIONS SINCE DETENTE* 226 (1987). One commentator suggested that large multinational companies generally have a reason to be present in the new Soviet (Russian) market if for no other reason than to await a gradual coming of a gigantic consumer and industrial markets for their products despite the lack of short-term opportunities for profitable investments. See Lee Smith, *Can You Make Any Money in Russia?*, FORTUNE, Jan. 1, 1990, at 104. As this commentator noted, "I came home persuaded that the conventional wisdom about the Soviet Union is right. This is mainly a market for big companies with deep pockets and distant vision." *Id.* at 107. Most old "corporate hands" in the Soviet Union also relied on various unorthodox business techniques in dealing with the Russians to overcome a myriad of operational difficulties. *Id.*

and was not widely published.¹² While some of the problems of the Soviet market from the point of view of the western investor have been inherited by the Russian Federation and other former Soviet republics, in the inherently unstable political and economic conditions of the Soviet Union in the late 1980's, the obstacles in the way of U.S. investment were virtually insurmountable. This explains the "wait and see" attitude then adopted by most U.S. companies toward the Soviet market.¹³

The second phase of foreign investment reform occurred from 1990 to mid-1991. The Union republics increasingly began to assert political sovereignty and economic independence. The old system, exemplified by the monopolistic all-Union ministries, state committees, and the hegemony of the Communist party, began to lose its grip over economic matters. Liberalization of prices, authorization for new forms of private enterprise, and the establishment of markets for goods, commodities, and securities across the country facilitated the transition toward a market economy. As the Soviet Union turned itself around and followed the path taken by the Central European countries in repudiating Marxist economic theory, western scholars and observers found the changes promising.

The Soviet central government, however, was not willing to adopt swift and radical measures to prepare for market-oriented economic relations nor to stabilize its rapidly disintegrating economy.¹⁴ During 1990, conservative elements in the central government repeatedly sought to sabotage the pace of economic and political reforms. They resisted the pressure from the more reform-minded economists, as well as from republican and municipal leaders, to start the privatization process. For much of 1991, a chaotic political stalemate existed between the Union republics and the central government. The struggle among the Communist ideologues, uprooted "apparatchiks" (government, party, and industrial bureaucrats), and the

¹² See *Investing in the Soviet Union; Russian Roulette with Six Bullets*, *ECONOMIST*, Jan. 12, 1991, at 64-65; Leyla Boulton, *The Russian Revolution*, *FIN. TIMES*, Mar. 20, 1992, at 14; Rothberg, *Study Finds Companies Holding Back on C.I.S. Investment*, Associated Press, Apr. 14, 1992 (source on file with the authors).

¹³ See *U.S. Firms Operating in the Soviet Union Face 'Enormous' Problems, Expert Says*, 6 Int'l Trade Rep. (BNA) 1484 (Nov. 15, 1989), available in LEXIS, BNA Library, Intrad File.

¹⁴ These measures were thought by many economists to be essential for the successful transition to market economics. See, e.g., *Investment Dollars Unlikely to Flow to USSR, Republics, Economists Say*, Daily Rep. Execs. (BNA) (Sept. 3, 1991), available in LEXIS, Nexis Library, Drexec File; Craig Forman, *Soviet Economy Holds Potential Disaster as the Union Weakens*, *WALL ST. J.*, Sept. 4, 1991, at A1.

western-minded reformers also continued to escalate.¹⁵ This "war of laws" between the various republics and the central government, including fighting for the right to have a priority in legislative and regulatory matters, effectively prevented additional foreign investment. The conflict also eroded a world-wide confidence that the U.S.S.R. was sufficiently stable for foreign investment.¹⁶ Foreign investors, although hopeful of the forthcoming reform, were paralyzed by the political instability caused by the disruption in the chain of political and economic command in the central and republican governments.

The political stalemate was resolved by the end of 1991, when the all-Union government collapsed after failing to persuade its former constituent republics to form a confederation or a new union on the basis of the so-called Union Treaty.¹⁷ The Soviet central government ran out of money and lost the trust of its citizenry. In an unprecedented peaceful transition of power, the Russian Federation took over the budget, banking system, political institutions, and foreign diplomatic missions from the former U.S.S.R. The hammer and sickle flag signifying the Communist rule of Moscow was taken down and replaced with the national tri-color Russian flag. The Russian republican government now has sole authority to legislate and regulate within the territory of the Russian Federation. Governments of the other former Soviet republics have similar unilateral authority within their respective territories.¹⁸ Several republics, however, have agreed to form a loose commonwealth structure (Commonwealth of Independent States or C.I.S.) and have entered into bilateral and multilateral economic cooperation treaties.¹⁹

¹⁵ See Petr O. Aven, *Economic Policy and the Reforms of Mikhail Gorbachev: A Short History, in WHAT IS TO BE DONE? PROPOSALS FOR THE SOVIET TRANSITION TO MARKET* 179-206 (Merton Peck & Thomas Richardson eds., 1991); Forman, *supra* note 14, at A1.

¹⁶ See Paul B. Stephan III, *Soviet Law and Foreign Investment: Perestroika's Gordian Knot*, 25 INT. LAW. 741, 751-53. "The larger problem in Soviet law today is the contest over the legitimacy of the various branches of the Soviet state . . . [which] reflects deeply felt hostility between the Union and many of the republics based on ideological and cultural conflicts as well as powerful historical grievances." *Id.*

¹⁷ See Elisabeth Rubinfiem, *Eleven Republics Lay U.S.S.R. to Rest*, WALL ST. J., Sept. 20, 1991, at A10; *Goodbye USSR, Hello C.I.S.*, WALL ST. J., Dec. 13, 1991, at A14.

¹⁸ See Louis Uchitelle, *As Soviet Republics Gain Power, U.S. Scrambles to Decide on a Policy*, N.Y. TIMES, Oct. 27, 1991, at E3.

¹⁹ The Slavic states of Russia, Byelorussia (now known as Belarus), and Ukraine were the original founders of the Commonwealth of Independent States on December 11, 1991. See *Goodbye USSR, Hello C.I.S.*, *supra* note 17, at A14. Eight European and Central-Asian republics of the former U.S.S.R.—Moldavia, Armenia, Azerbaijan, Kazakhstan, Tajikistan, Turkmenia, Uzbekistan, and Kirgizia—signed the Articles of the Commonwealth as co-founders on De-

In this, the third phase, the major remaining obstacles hindering foreign investment in the Russian and other former-Soviet republics are practical and logistic. No adequate infrastructure presently exists to provide the foreign investor with communications, transportation, supplies of raw materials, and parts and distribution of manufactured products. Some foreign companies already operating in Russia and other C.I.S. republics have found ways to compensate for the critical shortcomings of the fledgling post-Soviet commercial environment.²⁰ Others failed to adapt and withdrew from active participation in the C.I.S. market for three primary reasons: (1) the weak, paralyzed economy; (2) the lack of mature commercial culture, institutions, and infrastructure necessary for a viable market economy and; (3) middle- and low-level bureaucratic obstructionism.²¹ Pessimism over the potential for a full economic turnaround is perhaps the principal stumbling block to foreign companies' investment plans in the Commonwealth. In fact, predictions of food and fuel shortages in Russia last winter prompted western humanitarian agencies to donate food, medical supplies, and other essential items in an unprecedented joint NATO-Soviet supply airlift. It hence remains to be seen whether Russia and other former Soviet republics will achieve the same degree of success in adopting market economies as the countries of eastern and central Europe.

Nonetheless, looking beyond the immediate problems and assuming some economic stabilization and limited economic recovery in

ember 21–22, 1991 while Georgia joined the C.I.S. early in 1992. See *Slavic Shakeout*, WALL ST. J., Feb. 14, 1992, at A12. The Baltic states of Estonia, Latvia and Lithuania, although formerly Soviet republics, are not members of the C.I.S.. For the analysis of the Commonwealth and inter-C.I.S. treaties, see *infra* Part I. See also Preston Torbert, *The Commonwealth of Independent States: Its Legal Status and Implications for Foreign Companies*, in LEGAL AND PRACTICAL ASPECTS OF DOING BUSINESS IN SOVIET REPUBLICS (PLI Handbook Series No. 604, 1992).

²⁰ See, e.g., James Risen, *Once cautious, U.S. Firms Mean Business in Russia*, L.A. TIMES, June 20, 1992, at A1; Rona R. Mears, *Structural Challenges Facing the Republics*, in LEGAL AND PRACTICAL ASPECTS OF DOING BUSINESS IN THE SOVIET REPUBLICS, at 13 (PLI Handbook Series No. 604, 1992).

²¹ See generally Russian Federation: Economic Review (prepared by and available from the International Monetary Fund, Washington, D.C.) (Apr. 1992). Certainly, every responsible manager of a foreign company doing business in Russia should be aware of the internal economic limitations on the capacity to absorb foreign investment and trade imposed by mounting inflation (currently at 30 percent per month), devalued and inconvertible Russian currency (currently at the market exchange rate in excess of R700 to \$1), deficit of convertible currency (prompting defaults or debt rescheduling for many foreign currency loans formerly made to the Soviet Union), rising foreign debt (exceeding \$70 billion), and sharply fallen living standards for the average Russian. See, e.g., Rothberg, *supra* note 12.

the next two years,²² the long-term prospects for dramatically increased foreign investment in Russia and former Soviet republics are favorable. Changes in economic policy have removed most political and ideological obstacles to direct foreign investment, such as prohibitions on private ownership of property and means of production. Russia has expressly authorized foreign ownership of various assets, excluding land and natural resources. The legal environment now: (1) allows all forms of foreign investment—whether in the form of wholly-owned subsidiaries, entity or contract joint ventures, or branch and representative offices; (2) provides foreign investors with strong guarantees against state expropriation or nationalization; (3) imposes a relatively simple and streamlined registration regime for foreign investment with little government interference in business operations; and (4) permits profit repatriation in foreign currencies and reinvestment of ruble profits in Russia.²³ In light of these developments, some favorable comparisons can be made to the eastern European foreign investment regimes, which underwent similar metamorphoses earlier.

Furthermore, Russia has extensively modified the domestic legal environment to provide the foreign investor with a body of corporate and commercial law conceptually akin to western European commercial codes. The Russian legal system appears to be headed toward the western model in order to support the Russian version of the free market, or capitalist, system. To that end, Russia has enacted laws regarding joint-stock companies, taxation, monopolies, property, pledges, banking, insurance, bankruptcy, and privatiza-

²² For an analysis of how Russia and other C.I.S. states could benefit from the experience of other eastern European governments in bridging the gap between a centrally planned and market economy, see, e.g., *Economic Shock Therapy: Lessons for Russia from Eastern Europe*, Heritage Foundation Report, Dec. 13, 1991, available in LEXIS, Nexis Library, Hfrpts File. The Russian economic recovery may take various forms, perhaps evolving in a manner analogous to the Polish economic experiment with market economics. See Barry Newman, *Troubling Omen: Poland's Shaky Transformation to a Free Market Carries Warning for Soviets*, WALL ST. J., Sept. 13, 1991, at A10. Of course, there is no assurance that economic recovery will in fact come to Russia and other C.I.S. republics in this decade. See Steven Greenhouse, *The Soviet Fallback for Economic Reform: Hope for a Miracle*, N.Y. TIMES, Oct. 27, 1991, at E3 (describing the Russian economy as "half Dostoyevskian gloom and half Kafkaesque absurdity" and yet observing "a genuine desire on the part of the Russian people for a change leading to a more stable and rational economy"); see also *The Business Outlook II: Russia*, BUSINESS EASTERN EUROPE, Aug. 31, 1992, at 426, available in LEXIS, Europe Library, Bueeur File (forecasting that in 1992 western sales will decrease to \$18 billion, GNP will decline by 20 percent and unemployment will reach almost 6 million people).

²³ See *Eastern Europe: Attractive for Foreign Investment* in Focus: Eastern Europe, No. 54, Aug. 25, 1992 (available from Deutsche Bank Research).

tion.²⁴ This new legal infrastructure should adequately protect foreign investments and facilitate trade and investment transactions. Despite increasing similarities with western legal systems, however, the post-Communist legal systems in the C.I.S. are likely to remain distinct from western European or American jurisprudence due to the unique historical, political, and economic traditions of Russia and its former possessions.

Although foreign investment statistics on Russian and other C.I.S. states are still sketchy and tentative in contrast to the previous Soviet foreign investment regime, they do indicate a pattern of serious interest on the part of foreign investors in the emerging markets of the former Soviet Union. The total dollar amount of capital and property contributed to C.I.S. business ventures by western investors has significantly increased in 1991 and 1992, and analysts predict massive inflows of additional foreign investment into C.I.S. economies by the end of this decade, provided the C.I.S. states attain political and economic stability. In the meantime, available statistics support this article's premise that the new C.I.S. foreign investment regimes have encouraged and reassured western investors.

This article examines the development of legal regulation of foreign investment in Russia and other republics of the former Soviet Union. Part I describes the relations between the Russian Federation and other newly independent republics and the new Commonwealth in order to provide a description of the new framework in which business regulation is taking place in the C.I.S.. Additionally, this Part considers possible legal repercussions of the evolving economic and political relationship between the Russian Federation and the emerging Commonwealth, which has replaced the former Soviet Union. Part II outlines how foreign investment was regulated in the U.S.S.R. prior to major reform efforts in 1987. Part III additionally analyzes the three major stages of reform in the regulation of foreign investment of the former Soviet Union. In particular, it analyzes the new foreign investment law of the Russian Federation of 1991, which continues to govern foreign investment in Russia, and examines legal aspects of business operations of foreign-owned companies in the Russian Federation. Part III also examines some of the additional Russian and former Soviet legislation affecting foreign investment in the Russian Federation, the largest of the

²⁴ See, e.g., *Russia and the Republics' Legal Materials*, COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. (1992) (containing the unofficial English translations of many recent Russian legislative enactments) (source on file with the authors).

former Soviet republics in territory and population. Finally, Part IV outlines and compares the principal provisions of the foreign investment laws of Ukraine, Kazakhstan, and Belarus (formerly Byelorussia), the three largest republics after Russia of the former U.S.S.R.

I. RELATIONS BETWEEN THE RUSSIAN FEDERATION AND OTHER SOVEREIGN REPUBLICS UNDER THE OLD UNION AND THE NEW COMMONWEALTH

In order to understand the new "playing field" for foreign investors in the newly independent republics of the Commonwealth and the sources of legal regulation of foreign investment in their respective territories, it is essential to examine some recent historic developments leading to the establishment of the C.I.S. and dissolution of the Soviet Union. As this part explains, each C.I.S. republic has enacted its own foreign investment legislation which exclusively governs the rights and obligations of foreign legal entities and citizens. Regulation on the all-Union level ceased to have legal effect following the independence of the various republics and the withering away of the central all-Union authority. Historical reasons, however, demand an analysis of the political, socio-economic, and legal relations among the C.I.S. republics in the context of the former Union in order to obtain a more complete insight into the inter-republican relations and the republic's domestic legal regimes.

The centralized federal state which was known until recently as the Union of Soviet Socialist Republics (U.S.S.R. or Union) was formed in late 1922 by the republics of Russia, Ukraine, Byelorussia, and Transcaucasian Federation, which later came to be the republics of Georgia, Armenia and Azerbaijan.²⁵ In early 1924, the Second Congress of Soviets adopted the first constitution of the U.S.S.R. (First Soviet Constitution) on the basis of the 1922 Treaty of Union, which had established the federal structure of the new Union state.²⁶ The First Soviet Constitution created the all-Union Congress of

²⁵ See WILLIAM E. BUTLER, *SOVIET LAW* 153 (2d. ed. 1988); see generally U.S.S.R.: SIXTY YEARS OF THE UNION 1922-82 (1982).

²⁶ See BUTLER, *supra* note 25, at 145, 153. The First Constitution of the U.S.S.R. was preceded and heavily influenced by the Constitution of the Russian Soviet Federated Socialist Republic or Soviet Russia (R.S.F.S.R.) (R.S.F.S.R. Constitution), which was first drafted and put into effect in 1918, before the Soviet Union was formally created and the Soviet brand of federalism introduced into its legal system. See *id.* at 153. For the English translations of the R.S.F.S.R. Constitution and the First Constitution of the U.S.S.R., see U.S.S.R.: SIXTY YEARS OF THE UNION, *supra* note 25, at 69.

Soviets and a bicameral Central Executive Committee.²⁷ This political structure, resulting from constitutional debate which gave rise to the Treaty of the Union, was arguably the high point of Soviet federalism before the Gorbachev reforms.²⁸ While the First Soviet Constitution provided for a wide range of democratic rights in equal measure to citizens of all republics, it also disenfranchised a large part of the population, deemed "class enemies."²⁹ "Class enemies" included wealthy peasants, trade people, many professionals and religious leaders.³⁰ The political freedoms granted under this constitution to both individuals and political bodies generally proved to be illusory as the dictatorship of the proletariat did not tolerate any ideological dissent.³¹ The Communist Party, created by the Bolsheviks, was the real power broker in the Soviet Union. The Party exercised authority through the central committee and through

²⁷ See BUTLER, *supra* note 25, at 153; see generally ARYEH UNGER, CONSTITUTIONAL DEVELOPMENT IN THE USSR: A GUIDE TO THE SOVIET CONSTITUTIONS (1988).

²⁸ See Gregory Gleason, *Soviet Federalism and Republican Rights*, 28 COLUM. J. TRANSNAT'L L. 19, 28 (1990).

²⁹ The R.S.F.S.R. Constitution explicitly declared that "[t]he basic task of the Constitution . . . of the present transitional moment is the establishment of the dictatorship of the city and village proletariat and the poorest peasantry in the form of a powerful All-Russian state authority for the purpose of complete suppression of the bourgeoisie . . ." HAROLD J. BERMAN, JUSTICE IN THE USSR—AN INTERPRETATION OF SOVIET LAW 30 (1963). The First Constitution of the Soviet Union continued this trend of "revolutionary legal consciousness," by allowing overt discrimination against any and all persons of nonproletarian origin despite its guarantees to the proletarian constituency of a representative government. *Id.* at 35. The early Soviet policies of nationalization, expropriation, and mass destruction of human lives rationalized through the teachings of Karl Marx and Vladimir Lenin demonstrate well the effect of the bloody beginnings of this totalitarian regime on many of its citizens. See Gennady M. Danilenko, *Soviet Constitutional Reforms and International Human Rights Standards in 1 COLLECTED COURSES OF THE ACADEMY OF EUROPEAN LAW*, bk. 2, 226 (1992).

³⁰ During the period of so-called war communism in Russia, which continued well into the 1920s, "class enemies" of the communist state were defined in an arbitrary and the broadest imaginable way to include anyone who may potentially be a threat to the communist dictatorship. See Danilenko, *supra* note 29, at 226. Private business owners, in particular, despite a brief reprieve during NEP, were targeted for disenfranchisement of civil rights and subsequent extermination in Soviet Russia behind the official facade of a democratic government. See *id.* The R.S.F.S.R. Constitution granted civil and political rights only to "working and exploited people" and "guided by the interest of the working class as a whole," deprived the Russian citizens unable to meet the above requirements of such civil rights "as may be utilized by them to the detriment of the socialist revolution." *Id.*

³¹ See BUTLER, *supra* note 25, at 145; see also Robert Sharlet, *Party and Public Ideals in Conflict: Constitutionalism and Civil Rights in the USSR*, 23 CORNELL INT'L L.J. 341, 344–45 (1990). The history of Soviet violation of civil rights and of the many millions of victims claimed by the Soviet war communism is well-documented. See, e.g., Danilenko, *supra* note 29, at 224–30.

republican and local branches. The Party was not subject to any external control.³²

By the time it adopted its second constitution in December 1936,³³ the Union included 11 republics. The major change involved the universal right to vote a secret ballot.³⁴ In reality, most political rights granted to individuals in the Soviet single-party state were a fiction.³⁵

The rapid industrialization and modernization of the economy under Stalin brought about the centralization of the state machinery. The central authority in Moscow effectively dictated political, economic, and social policy to the constituent republics.³⁶ The constitutions of the Soviet republics, substantially modeled after the all-Union constitution, theoretically allowed the republics their own policy-making institutions and political organizations. In practice, however, the republics had no substantial independence from the all-Union government dominated by Russians.³⁷

The annexation of Moldavia and the three Baltic republics by the Soviet Union in 1939 brought the number of Union republics to fifteen, where it remained until the late 1980s when the Union crumbled.³⁸ The third, and final, constitution of the U.S.S.R. was

³² See Vladimir N. Brovkin, *The Politics of Constitutional Reform: The New Power Structure and the Role of the Party*, 23 CORNELL INT'L L. J. 323, 323-24 (1990).

³³ See BUTLER, *supra* note 25, at 145.

³⁴ See Gleason, *supra* note 28, at 29. The Soviet government, largely unburdened by the western democratic traditions of judicial review, separation of powers, and freely elected representative government, continued to be a mere tool for implementation of the monolithic communist party's will, whose politburo (the highest decision-making body) was invariably enjoying complete supremacy. See BERMAN, *supra* note 29, at 52.

³⁵ For instance, freedom of speech, freedom of press, freedom of assembly, and freedom of street processions and demonstrations were granted only in conformity with the interests of the working people and in order to strengthen the socialist system. See Constitution of U.S.S.R., Dec. 5, 1936, as amended Oct. 1, 1968, art. 125, translated in HAROLD J. BERMAN & JOHN B. QUIGLEY, BASIC LAWS ON THE STRUCTURE OF THE SOVIET STATE 3-28 (1969). Although class-oriented general restrictions were removed, the conditional nature of the basic human rights remained only to be carried over into the Third Constitution. See Danilenko, *supra* note 29, at 226-27; see also Peter H. Juviler, *Guaranteeing Human Rights in the Soviet Context*, 28 COLUM. J. TRANSNAT'L L. 133, 140-41 (1990).

³⁶ See Gleason, *supra* note 28, at 29; BERMAN, *supra* note 29, at 52.

³⁷ BERMAN, *supra* note 29, at 52. The post-World War II Soviet anthem—replacing “the International”—was quite revealing of the role Russia was to play in the Union. Its lyrics were, in part, as follows: “Unbreakable union of free republics joined together by the great Russia. . . .”

³⁸ See *supra* notes 35-37. The colonial pretensions of the Soviet Russia became even more obvious during the period of the Cold War when it established a communist alliance with its eastern European neighbors and continued to expand its control and influence far outside the traditional boundaries of the Russian empire. See generally R. JUDSON MITCHELL, IDEOLOGY OF A SUPERPOWER: CONTEMPORARY SOVIET DOCTRINE ON INTERNATIONAL RELATIONS (1982).

adopted in 1977 (Third Soviet Constitution). It fully reflected the centrist attitude of the Brezhnev government, and it failed to make any substantive changes in the relationship between the central government and the republics.³⁹

The policies of glasnost and perestroika under Mikhail Gorbachev brought ethnic tensions and seemingly dormant feelings of nationalism to the forefront.⁴⁰ The Baltic republics, whose less than voluntary joinder with the Union perhaps had the least legitimacy, took the lead in declaring independence from the Soviet Union.⁴¹ By August 1991, when a group of Communist hardliners attempted a coup to gain control of the Soviet government, all of the constituent republics had proclaimed their independence.⁴² The coup accelerated the devolution of power to the republics, giving them greater authority and political autonomy.⁴³

The contemporary Russian policy in the republics of the Soviet Union has left a profound effect on its relations with the former Soviet republics today and may explain some of the animosity these newly independent republics feel toward Russia in the post-Soviet period. See generally Thomas J. Samuelian, *Cultural Ecology and Gorbachev's Restructured Union*, 32 HARV. INT'L L.J. 159, 168 (1991). The Baltic states would probably serve as the best example of deteriorated diplomatic relations between Russia and other former Soviet republics after the break-up of the U.S.S.R. For the history of the forceful inclusion of the Baltic states into the Soviet Union, see, e.g., William J.H. Hough III, *The Annexation of the Baltic States and Its Effect on the Development of Law Prohibiting Forcible Seizure of Territory*, 6 N.Y.L. SCH. J. INT'L & COMP. L. 301 (1985).

³⁹ See Gleason, *supra* note 28, at 30–31. For a general discussion of the status of the all-Union constitution in the Soviet legal system of the 1970s and republics' rights in the Union of that period, see generally Christopher Osakwe, *The Theories and Realities of Modern Soviet Constitutional Law*, 127 U. PA. L. REV. 1350 (1979). It also should be noted that the Third Constitution was amended one last time under President Gorbachev to provide for a somewhat expanded definition of individual property rights and minor changes in the federal structure of the union. See U.S.S.R. Law on the Amendments and Additions to the Constitution of the U.S.S.R., 49 Ved. Verkh. Sov. SSSR Item 727 (1988) (source on file with the authors).

⁴⁰ See David Satter, *The Seeds of Soviet Instability*, WALL ST. J., Sept. 20, 1991, at A10; Gerald F. Seib, *U.S. Loses Hope that Coherent Economy Will Link Nationalistic Soviet Republics*, WALL ST. J., Oct. 28, 1991, at A10; Andrei Kozyrev, *A Weak Russia is Dangerous to the West*, MOSCOW NEWS, Oct. 21, 1992, available in LEXIS, Nexis Library, Mosnws File.

⁴¹ The first Union republic which declared independence was Lithuania. See Act on the Restoration of the Lithuanian State, Ved. Lit. SSR, No. 9 (1990), item 222 (source on file with the authors). The Congress of People's Deputies of the U.S.S.R. invalidated this act by a special decree. See Ved. SSSR, No. 12 (1990), item 194 (source on file with the authors); *Experts See Business Opportunities in Baltics, But Insist Enormous Challenges Remain*, E. Eur. Rep. (BNA) 40–44 (Oct. 28, 1991), available in LEXIS, BNA Library, EERPT File.

⁴² See, e.g., Declaration of State Sovereignty of the Russian Soviet Federated Socialist Republic, translated in W.E. BUTLER, BASIC DOCUMENTS ON THE SOVIET LEGAL SYSTEM 139–41 (1991); see also Satter, *supra* note 40, at A10.

⁴³ See *After the Coup: Political Upheaval Forces Reassessment of Legal Issues*, 2 SOVIET BUS. L. REP., Sept. 20, 1991, available in LEXIS, Nexis Library, RCBLR File.

In a final attempt to preserve the Union, Gorbachev negotiated the Treaty on Economic Union (Economic Treaty), signed by eight republics on October 18, 1991.⁴⁴ The final version of the treaty provided for coordinated economic policy in the areas of currency, banking, transportation, and energy.⁴⁵ Under the agreement, each republic of the economic community formerly constituting the U.S.S.R. became an equal legal entity.⁴⁶ The members of the community stipulated that they would preserve the ruble as the single unit of currency, create a unified banking system, and pursue coordinated budget and taxation policies.⁴⁷ Member-states also agreed to assume the foreign obligations of the U.S.S.R., and proposed to establish a bank to handle international transactions as a legal successor to the U.S.S.R. Vnesheconombank.⁴⁸

This economic union, however, never enjoyed the full support of all of the republican leaders. In fact, it was never joined by the Ukraine, the second largest republic. Instead, on December 8, 1991, the leaders of Russia, Ukraine, and Byelorussia came together to

⁴⁴ For the English translation of the Treaty on Economic Union, see E. Eur. Rep. (BNA) 47-52 (Oct. 28, 1991), available in LEXIS, BNA Library, EERPT File [hereinafter Economic Treaty]. The Economic Treaty was signed by all former Soviet republics except Ukraine, Azerbaijan, Georgia, and Moldavia. See *Terms of Economic Treaty Outlined; Effectiveness Questioned Without Ukraine*, SOVIET BUS. L. REP., Oct. 21, 1991, at 3-4, 7, available in LEXIS, Nexis Library, RCBLR File; *Signing of Economic Treaty; No Guarantee of Political Accord*, E. Eur. Rep. (BNA) 4-5 (Oct. 28, 1991), available in LEXIS, BNA Library, EERPT File; see also *Eight Soviet Republics Sign Economic Treaty*, FIN. TIMES, Oct. 19, 1991, at 1.

⁴⁵ See Economic Treaty, *supra* note 44, art. 5; see also Cullen, *Pact Leaves Many Unanswered Questions*, 3 East/West Bus. Rep., Nov. 1991, at 1 (source on file with the authors).

⁴⁶ See Economic Treaty, *supra* note 44, art. 1. This equality and independence granted under the Economic Treaty to the former U.S.S.R. republics would have presumably afforded them more latitude in practice than previously was granted under the Soviet constitutions. The Soviet constitutions hypocritically granted the Union republics the rights to sovereignty and to secession from the Soviet Union, although no Union republic prior to President Gorbachev's rule could exercise these rights in practice. See U.S.S.R. Constitution of 1977 art. 76, translated in W.E. BUTLER, BASIC DOCUMENTS ON THE SOVIET LEGAL SYSTEM 3-32 (1983); see also U.S.S.R. Law on the Fundamentals of Economic Relations Between the U.S.S.R. and the Union and Autonomous Republics of April 10, 1990, translated in BUTLER, *supra* note 42, at 235-42; U.S.S.R. Law on the Delimitation of Powers Between the U.S.S.R. and Subjects of the Federation, Apr. 26, 1990, translated in BUTLER, *supra* note 42, at 45-49; U.S.S.R. Law on the Agencies of State Power and Government of the U.S.S.R. in the Transition Period, Sept. 5, 1991, translated in BUTLER, *supra* note 42, at 17-19 (providing for a new statutory federalist framework of political and economic relations between the center (the all-Union government) and individual Union-republics); *Draft Union Treaty Provokes Concerns Over Taxation, Property*, SOVIET BUS. L. REP., Oct. 7, 1991, at 2.

⁴⁷ See Economic Treaty, *supra* note 44, arts. IV, V.

⁴⁸ See *id.* arts. 20-21; *Final Version of Economic Treaty Contains Changes*, 2 SOVIET BUS. L. REP., Nov. 1, 1991, available in LEXIS, Nexis Library, RCBLR File.

form the new Commonwealth of Independent States (Commonwealth or C.I.S.), declaring it the successor to the former Soviet Union.⁴⁹ Eight other republics joined the Commonwealth in late December of 1991.⁵⁰ Thus, with the exception of the Baltic states, which have pursued the path of self-sufficiency and independence, and Georgia, which was prevented from participation in the Union by internal political turmoil, all of the republics which previously constituted the Soviet Union now form the Commonwealth. It should be noted, that although the former Soviet republics have attained full political independence, the Russian Federation is the economically superior power. As a result of its previous domination of the Soviet industrial apparatus, ministries, and fiscal and planning agencies, the Russian Federation exerts a disproportionately greater influence on the economies of the other republics.⁵¹

The members of the new Commonwealth reached agreement on certain political issues: the recognition of the independence of the republics and their current borders; the succession of Russia to the U.S.S.R.'s seat on the United Nations Security Council; and the transfer of all nuclear weapons to the control of the Russian Federation.⁵² The matters of defense and military command, however, remain subjects of controversy.⁵³ The demise of the Soviet Union left its successor republics with a number of unresolved basic issues. These issues include division of the previously highly-integrated Soviet economy, financing of the new republican, regional, and

⁴⁹ The two documents formally establishing the Commonwealth were the Accords of Minsk and Alma Ata. See Armenia-Azerbaijan-Belarus-Kazakhstan-Kyrgyzstan-Moldova-Russian Federation-Tajikistan-Uzbekistan-Ukraine: Agreements Establishing the Commonwealth of Independent States, Done at Minsk, Dec. 8, 1991, and at Alma-Ata, Dec. 21, 1991, *translated in* 31 I.L.M. 138 (1992); see also *Accords of Minsk and Alma Ata*, 2 COLUM. PARKER SCH. SOV. & E. EUR. L. BULL., 1 (1991) (source on file with the authors). This and other political developments initiated by the Russian republic government removed the central bureaucracy and, despite questions of legality under Soviet and international laws, set the stage for a prompt dissolution of the Soviet Union as a political entity. See *New Commonwealth May Create Favorable Environment for Legal Framework*, SOVIET BUS. L. REP., Dec. 16, 1991, at 3, 10, available in LEXIS, Nexis Library, RCBLR File.

⁵⁰ See *The End of the Soviet Union*, N. Y. TIMES, Dec. 22, 1991, at 12. By then, the Union completely collapsed and the new Commonwealth marked a new milestone in the evolution of the former Russian and Soviet empires, under which individual republics, including Russia itself, received international recognition as independent and sovereign states. See *U.S. Welcomes Declaration Announcing Union of Russia, Ukraine, Byelorussia*, E. EUR. REP. (BNA) 206 (Dec. 23, 1991), available in LEXIS, BNA Library, EERPT File.

⁵¹ See *What's Behind Yeltsin's New Commonwealth*, ECONOMIST, Jan. 4, 1992, at 39.

⁵² See *Minsk: No C.I.S. Accord on Armed Forces*, Current Digest of the Post-Soviet Press, Mar. 18, 1992, at 1, available in LEXIS, Nexis Library, CDSP File.

⁵³ *Id.*

municipal governments, and creation of agencies to facilitate inter-republican trade, customs procedures, and currency exchange mechanisms.⁵⁴

Certain republics, however, have established bilateral economic cooperation treaties which attempt to coordinate economic matters.⁵⁵ Such vital economic sectors as banking, insurance, and securities brokerage lack interrepublic integration, underscoring the need for better interrepublic coordination on such issues. Policy making and promulgation of new rules by republican regulators also lack sufficient coordination. The isolationist policy pursued by many newly independent states of the C.I.S. has predictably created havoc in the previously highly-interconnected Soviet economy. For example, the current monetary policies of the C.I.S. republics reflect this lack of political and economic maturity. Until recently, all republics of the Commonwealth—and even the Baltic states—continued to use the old Soviet ruble.⁵⁶ Understandably, an action by the central bank of one republic immediately affects the other republics. When the Russian Federation commenced its pricing liberalization, many other Commonwealth republics had to do the same because of the common currency and heavy dependence on interrepublican trade.⁵⁷ The introduction of new units of currency, including a new Russian ruble, is the only practical solution to the economic discord among the republics of the C.I.S., short of complete coordination of fiscal matters which is an unlikely political alternative.⁵⁸

Although the aborted economic union treaty may provide some guidance in these matters,⁵⁹ it is more beneficial to consider the laws and regulations promulgated by each republic's legislative and ad-

⁵⁴ See *The End of the Soviet Union*, *supra* note 50, at 12; *Saving Soviet Trade*, FIN. TIMES, Nov. 21, 1991, at 22; Peter McGrath, *Articles of DisUnion*, NEWSWEEK, Sept. 16, 1991, at 45.

⁵⁵ See, e.g., *RSFSR, Ukraine Forge Agreement, Could Be Model for Others*, 2 SOVIET BUS. L. REP., Sept. 20, 1991 (describing trade agreements between certain C.I.S. states), available in LEXIS, Nexis Library, RCBLR File.

⁵⁶ See *The Ruble Zone: Rubleless and Rudderless*, KOMMERSANT, June 30, 1992 (source on file with the authors) (Baltic states introduce new currencies).

⁵⁷ See *Kravchuk Sees Greater Powers; Tensions with Russia Persist*, RUSSIA & COMMONWEALTH BUS. L. REP., Feb. 10, 1992, at 2, 9-10, available in LEXIS, Nexis Library, RCBLR File.

⁵⁸ See John Loyd & Dmitri Volkov, *Russia Cracks the Whip Over the Ruble Zone*, FIN. TIMES, July 31, 1992, at 2; Janet Guttman, *Former Soviet States Struggle to Establish Own Currency*, TORONTO STAR, Aug. 17, 1992, at C1.

⁵⁹ The provisions of the Economic Treaty, though politically unacceptable to some C.I.S. republics, did mandate a much closer cooperation and coordination between the individual republics of the former Soviet Union than those of the C.I.S. Accords. See *Compromise Agreement with Republics May Change How Business is Done in the USSR*, SOVIET BUS. L. REP., May 1991, at 3-4, 10, available in LEXIS, Nexis Library, RCBLR File.

ministrative bodies. There is presently no comprehensive multilateral network of inter-republican treaties. Some former Soviet republics, however, have taken steps to reaffirm international treaties previously entered into by the Soviet Union.⁶⁰

Certain laws of the former Soviet Union, particularly those enacted recently, remain important to foreign investors for two reasons. First, some republics are adopting, with minor modifications, former Soviet laws, such as the foreign investment and the company laws.⁶¹ Second, certain areas of substantive private civil law, such as protection of intellectual property and contractual relations, are covered only by former Soviet law in many C.I.S. republics. These former Soviet laws may remain in effect in the territory of the republics except where explicitly repudiated by the republican governments.⁶² Nevertheless, national laws and regulations of individual C.I.S. republics, particularly those on foreign investment, predominate the legislative landscape and should be given utmost attention due to their "preemptive" effect. It should be noted that significant differences do exist among the laws of Russia and other former Soviet republics resulting in many variations on the Soviet and Russian foreign investment models analyzed in this article.⁶³

II. FOREIGN INVESTMENT IN THE U.S.S.R. BEFORE 1987

Foreign investment in the U.S.S.R. prior to 1987 had been confined to industrial cooperation agreements comprising co-production, licensing, subcontracting, and turnkey agreements.⁶⁴ Despite the lack of laws authorizing direct foreign investment in the Soviet territory, foreign trade with the West has been significant. In fact, at times it has reached one-third of the total foreign trade volume, a substantial figure compared to the internal COMECON

⁶⁰ See *US Recognizes All Soviet Republics, Will Move Soon on Relations with Six*, E. Eur. Rep. (BNA) (Jan. 6, 1992), available in LEXIS, BNA Library, EERPT File; *Minsk: No C.I.S. Accord on Armed Forces*, *supra* note 52, at 1.

⁶¹ See discussion *infra* part IV.

⁶² See Decree on Measures to Ensure the Economic Foundation for Sovereignty of the Russian Federation; Decree on Application of the U.S.S.R. Law in the Territory of the R.S.F.S.R., Dec. 1991; see also *The Decree By the President of Russia*, SOVDATA DIALINE-BIZEKON NEWS, Aug. 23, 1991, available in LEXIS, Europe Library, Sovco File; see George W. Carey, *Five Years Later: Evaluating Foreign Investment Experience in the Former USSR*, in LEGAL AND PRACTICAL ASPECTS OF DOING BUSINESS IN THE SOVIET REPUBLICS, at 57-58 (PLI Handbook Series No. 604, 1992).

⁶³ See discussion *infra* part IV for the discussion of foreign investment laws of three representative C.I.S. republics: Belarus, Ukraine and Kazakhstan.

⁶⁴ See Pedersen, *supra* note 4, at 392-93; Stephan, *supra* note 16, at 742.

foreign trade.⁶⁵ Under the U.S.S.R. Constitution, foreign direct investment was legally impossible.⁶⁶ The essential elements of the Soviet economic structure were state ownership of all means of production and distribution, as well as central planning of all economic activity by the various U.S.S.R. ministries.⁶⁷

Consequently, direct foreign investment, which required equity participation by foreign entities, was an utter impossibility. Joint ventures physically located outside the Soviet Union and formed under non-Soviet law, however, were encouraged by the Soviet government.⁶⁸ Representative offices of foreign companies and banks were permitted to act as agents for their head offices, to negotiate trade and industrial agreements with authorized Soviet organizations, and to achieve certain other objectives.⁶⁹ These representative offices served a primarily facilitative role, rather than serving as vehicles for foreign investment.⁷⁰

⁶⁵ See Joan P. Zoeter, *USSR: Hard Currency Trade and Payments*, U.S. Congress, Joint Economic Commission, in *SOVIET ECONOMY IN THE 1980s* 294 (1982); see also Stephan, *supra* note 16, at 742; see generally Harold J. Berman & George L. Bustin, *The Soviet System of Foreign Trade*, 7 *LAW & POL'Y INT'L BUS.* 987 (1975).

⁶⁶ In particular, Article 17 of the 1977 Constitution of the U.S.S.R. provided that [private] economic [business] activity in the Soviet Union is possible only if "based exclusively on the individual labor of citizens and members of their families," essentially banning enterprises using hired labor. Article 11 of the 1977 Constitution reserved the ownership of basic means of production in industry and agriculture to the state. See U.S.S.R. Constitution of 1977, *supra* note 46.

⁶⁷ See Peter B. Maggs, *Constitutional Implications of Changes in Property Rights in the USSR*, 23 *CORNELL INT'L L.J.* 363, 363-64 (1990).

⁶⁸ In fact, some Soviet state enterprises and organizations have been actively involved in direct investment abroad, in socialist and capitalist developed and developing countries, since the 1930s. See *MNCs and Joint Ventures: Not All Are West-to-East*, 26 *BUSINESS EASTERN EUROPE*, June 29, 1987, at 205, available in LEXIS, Europe Library, Bueeur File (describing Soviet joint venture banks and trading companies created in western Europe and North America as examples of pre-1987 joint ventures abroad); see generally CARL H. McMILLAN, *MULTINATIONALS FROM THE SECOND WORLD: GROWTH OF FOREIGN INVESTMENT BY SOVIET AND EASTERN EUROPE ENTERPRISES* (1987).

⁶⁹ See generally *EAST WEST TRADE* (Price Waterhouse, 1976) (source on file with the authors).

⁷⁰ Under the Regulations governing the establishment and operations of representative offices of foreign firms, such representative offices were highly restricted in their business operations and could only facilitate the realization of agreements on cooperation with Soviet counterparts in trade, finance and other spheres, investigate opportunities for such cooperation, exchange information and assist in the execution of transactions. See U.S.S.R. Council of Ministers Decree No. 1074 of November 30, 1989 On Approval of the Regulations of the Procedure for the Opening and Activity in the U.S.S.R. of Representative Offices of Foreign Firms, Banks and Organizations, *Sobr. Uk. SSSR*, No. 1, art. 5, Item 8 (1990) [hereinafter Decree No. 1074]; see also John F. Sheedy & Richard N. Dean, *Gaining a Foothold in the Soviet Market: How to Establish a Representative Office*, 25 *INT. LAW.* 103, 109-10 (1991); see generally Pyotr S. Rabinovich, *The Procedure for Signing Transactions with Soviet Foreign Trade Organizations*, 22 *INT'L LAW.* 143 (1988); Ramzaitsev, *The Application of Private International Law in Soviet Foreign Trade Practice*, 1961 *J. BUS. L.* 344.

III. THREE STAGES OF REFORM

A. *Foreign Investment Regime In The U.S.S.R.: 1987-1990*

As part of its policy of "perestroika" and in an effort to revitalize the stagnating Soviet economy, the Soviet leadership in late 1986 began taking steps to encourage foreign investment in the U.S.S.R.⁷¹ The Decree on Joint Enterprises adopted by the Presidium of the U.S.S.R. Supreme Soviet on January 13, 1987 (Joint Venture Decree) authorized joint ventures for the first time since the 1930s.⁷² The joint enterprise, as a product of the Joint Venture Decree, was a novel form of organization without precedent in Soviet jurisprudence. It combined elements of both a partnership and a corporation.⁷³ This form of business organization was needed because the Soviet legal system did not then include a body of law devoted to private business entities suitable for foreign investment.⁷⁴

Between 1987 and 1991, the joint enterprise constituted the single essential vehicle for direct foreign investment in the U.S.S.R. Its initial organizational aspects were fairly rigid.⁷⁵ Although the Joint Venture Decree was amended several times during the first four years⁷⁶ to offer foreign investors additional flexibility, in the broader perspective of Soviet law, which was fully applicable to all activities of joint ventures, the regulatory structure for joint enterprises was still quite restrictive.⁷⁷ For instance, the Joint Venture Decree initially

⁷¹ McIntire, *Soviet Efforts to Revamp the Foreign Trade Sector*, Office of Soviet Analysis, Central Intelligence Agency, in *LEGAL AND PRACTICAL ASPECTS OF DOING BUSINESS WITH THE SOVIET UNION*, at 340 (PLI Handbook Series No. 464, 1988) (source on file with the authors).

⁷² Decree On Questions Concerning the Establishment in the Territory of the U.S.S.R. and Operations of Joint Ventures, International Amalgamations and Organizations with the Participation of Soviet and Foreign Organizations, Firms and Management Bodies, *Vedomosti Verkhovnovo Soveta SSSR* (1987) No. 2, item 35 (source on file with the authors); see generally *THE SOVIET JOINT ENTERPRISE DECREE: LAW AND STRUCTURE* (Kelley & Saul, eds., Russian Research Center, Harvard University, 1989) (source on file with the authors).

⁷³ See generally, Tracy E. Aronson, *The New Soviet Joint Venture Law: Analysis, Issues and Approaches for the American Investor*, 19 *LAW & POL'Y INT'L BUS.* 851 (1987).

⁷⁴ See Russell H. Carpenter & Bradford Smith, *U.S.-Soviet Joint Ventures: A New Opening in the East*, 43 *BUS. LAW.* 79 (1987).

⁷⁵ See HOBER, *supra* note 1, § IV.B(4).

⁷⁶ See *infra* notes 86-92 and accompanying text.

⁷⁷ A leading commentator on the Soviet joint venture legislation has described the false expectations of western investors with respect to the Joint Venture Law, specifically the erroneous assumption that the Joint Venture Law would allow them to escape the obstructionism of Soviet bureaucracy and antiquated Soviet law ill-conceived to regulate private business entities:

The single major disadvantage of this device is the fact that it is regulated at every step of the way by Soviet domestic law. Many Western investors choose to set up a

required that at least one of the top executives of the joint venture be a Soviet citizen, that the Soviet party have a preemptive right to buy the ownership share proposed to be transferred by the foreign participant,⁷⁸ and that the Soviet participant maintain a majority ownership of the enterprise.⁷⁹ As a result of the amendments to the Joint Venture Decree, some of these restrictions were subsequently eliminated; however, the rules governing valuation of participants' capital contributions, currency conversion, accounting, and other operational aspects of the joint enterprise's formation and business activities remained intact.⁸⁰ Nevertheless, western businesses eager for new untapped markets for their products and services reacted enthusiastically to the Soviet joint enterprise format of doing business. By late 1989, western business signed in excess of eleven hundred agreements to conclude joint ventures with Soviet partners in the joint enterprise form.⁸¹ As of 1989, about five hundred joint enterprises commenced legal existence, with three hundred capitalized and starting operations.⁸² By early 1990, some fifteen hundred joint enterprises had been registered in the U.S.S.R.⁸³

In addition to the original decree of January 13, 1987, which authorized the establishment of joint enterprises and set forth general guidelines for their establishment and operations,⁸⁴ two other

joint venture with a Soviet partner in the mistaken belief that, in the operation of their enterprise, they can avoid the vicissitudes of Soviet law by writing their joint venture contract in such a way as would exempt them from the application of that law. That would be quite impossible.

CHRISTOPHER OSAKWE, *SOVIET BUSINESS LAW—INSTITUTIONS, PRINCIPLES AND PROCESSES* § 1.26 (1992).

⁷⁸ See Decree No. 49, *supra* note 3, art. 16.

⁷⁹ See *supra* notes 71–76 and accompanying text.

⁸⁰ See Daniel J. Arbess, *A Few Things U.S. Businesspeople Should Know About Joint Ventures in the Soviet Union: A Lawyer's View*, 22 N.Y.U. J. INT'L L. & POL. 411, 418–19 (1990); David M. Bost, *The 1987 Soviet Joint Venture Law: New Possibilities for Cooperation and Growth in East-West Relations*, 17 DENV. J. INT'L L. & POL'Y 581, 587–91 (1989).

⁸¹ Lowentz, *Introduction Guide to Joint Ventures in the Soviet Union*, in *LEGAL ASPECTS OF TRADE AND INVESTMENT IN THE SOVIET UNION AND EASTERN EUROPE* (PLI Handbook Series No. 549, 1990) (source on file with the authors).

⁸² See George W. Carey, *The Soviet Joint Venture Laws: Their Provisions and Purposes*, in 1989: A NEW LOOK AT DOING BUSINESS WITH THE SOVIET UNION, at 85 (PLI Handbook Series, 1989).

⁸³ See *Soviet Joint Ventures: Developments Through the First Quarter of 1990*, PlanEcon Report, Vol.6, No.17, Apr. 27, 1990 (source on file with the authors).

⁸⁴ Decree of the Presidium of the Supreme Soviet No. 6362-XI On Questions Concerning the Establishment on Territory of the U.S.S.R. and Operation of Joint Ventures, International Amalgamations and Organizations, Firms and Management Bodies, Jan. 13, 1987, *translated in* *LEGAL ASPECTS OF TRADE AND INVESTMENT IN THE SOVIET UNION AND EASTERN EUROPE*, at 441, App. A (PLI Handbook Series No. 549, 1990) (source on file with the authors).

fundamental legislative acts (collectively called the Joint Venture Law) governed joint ventures in Russia and the Soviet Union until the 1990 reforms.⁸⁵ The first was Decree No. 1074 of the U.S.S.R. Council of Ministers of September 17, 1987 (Decree No. 1074),⁸⁶ which supplemented and modified the Joint Venture Decree in certain respects. The second act (not specifically issued with respect to joint ventures but applying to them as well) by the Soviet central government was Decree No. 1405 of the U.S.S.R. Council of Ministers Decree of December 2, 1988 (Decree No. 1405),⁸⁷ which addressed a host of problems associated with the earlier legislation and significantly liberalized a number of major provisions of the Joint Venture Law.⁸⁸ Soviet ministries and state committees also issued a host of regulations and instructions to complement the Joint Venture Law and to provide further guidance in special situations.⁸⁹ In 1990, many commentators believed that the Joint Venture Law needed further revisions to stimulate any sizable level of foreign investment.⁹⁰ Soviet government advisors circulated a draft law in Soviet ministries which consolidated the previous enactments and improved the conditions for the foreign investor in the joint enterprises.⁹¹ The proposed law, however, never was enacted due to the radical overhaul of the Soviet foreign investment regime, which rendered the joint enterprise structure superfluous.⁹²

⁸⁵ See CHRISTOPHER OSAKWE, JOINT VENTURES WITH THE SOVIET UNION: LAW AND PRACTICE 52 (1990).

⁸⁶ Decree of the Central Committee of the C.P.S.U. and of the U.S.S.R. Council of Ministers No. 1074 On Additional Measures to Streamline Foreign Economic Activity in the New Conditions of Economic Management, Sept. 17, 1987, in LEGAL ASPECTS OF TRADE AND INVESTMENT IN THE SOVIET UNION AND EASTERN EUROPE, at 467, App. A IV (PLI Handbook Series No. 549, 1990) (source on file with the authors).

⁸⁷ See U.S.S.R. Council of Ministers Decree No. 1405 On Further Developing the Foreign Economic Activity of State Cooperative and Other Public Enterprises, Associations, and Organizations, Dec. 2, 1988, 2 SP SSSR Item 7 (1989), reprinted in EKONOMICHESKAYA GAZETA, No. 51, Dec. 1988, at 17-18, translated in Foreign Broadcasts International Service - Soviet Union (FBIS-SU), Dec. 19, 1988, at 61 [hereinafter Decree No. 1405].

⁸⁸ For instance, the decree significantly liberalized the foreign trade regime to which joint enterprises were subjected and streamlined registration procedures for engaging in foreign trade. See S. Gerald Saliman, *An Analysis of the Changing Legal Environment in the USSR For Foreign Investment*, 22 LAW & POL'Y INT'L BUS. 1, 7-9 (1991); see generally HOBER, *supra* note 1, § V.

⁸⁹ See generally EUGENE THEROUX & ALEXANDER GEORGE, JOINT VENTURES IN THE SOVIET UNION: LAW AND PRACTICE (1988).

⁹⁰ See, e.g., Saliman, *supra* note 88, at 30-33; see generally Christopher Osakwe, *A Clinical Analysis of the 1990 Draft of a New Soviet Joint Venture Law*, presented at the Presidential Showcase Program, *Legal Aspects of Investment in the New Eastern Europe*, Aug. 7, 1990.

⁹¹ *Id.*

⁹² See discussion *infra* part III.B.

Under the Joint Venture Law, as it existed before 1991, the joint enterprise, as a juridical (corporate) entity,⁹³ enjoyed limited liability similar to that of U.S. corporations. The foreign participant in the joint enterprise received some protection for its capital and assets contributed to the authorized statutory fund⁹⁴ of the enterprise against administrative requisition or expropriation by the Soviet government.⁹⁵ Initially, the western participant's share of ownership, determined by the equity participation in the statutory fund, was limited to 49 percent.⁹⁶ Subsequently, this restriction was removed, thereby allowing foreign participants to hold up to 99 percent equity ownership in the joint enterprise.⁹⁷ Contributions to the statutory fund could be made in cash or in tangible or intangible assets.⁹⁸ The western participant frequently made its contribution in convertible currency and technology, while the Soviet partner contributed structures and equipment.⁹⁹ The Joint Venture Law required that the personnel of a joint enterprise be mostly Soviet citizens.¹⁰⁰ The original requirement that the Chairman of the Board and the Director General be Soviet citizens was later removed.¹⁰¹

The joint enterprise format of business organization involved extensive supervision by Soviet administrative authorities, including registration and reporting requirements.¹⁰² Registration of a joint enterprise required preparation of a set of legal documents—commonly called the foundation documents which included a feasibility study, a joint venture agreement, and a charter.¹⁰³ The parties would submit the foundation documents for approval to the administrative authority overseeing the Soviet partner and then to the Ministry of

⁹³ See Decree No.49, *supra* note 3, art. 9.

⁹⁴ See *id.* art. 15.

⁹⁵ See *id.*

⁹⁶ See *id.* art. 5.

⁹⁷ See Decree No. 1405, *supra* note 87, art. 31.

⁹⁸ See Decree No. 49, *supra* note 3, art. 11.

⁹⁹ See Arbess, *supra* note 80, at 416–19 (discussing operational aspects of capitalizing joint enterprises).

¹⁰⁰ See Decree No. 49, *supra* note 3, art. 47.

¹⁰¹ See Decree No. 1405, *supra* note 87, art. 31.

¹⁰² See Decree No. 49, *supra* note 3, arts. 2, 9, 44–46.

¹⁰³ See *id.* arts. 2, 8, 9. A feasibility study served as the basis upon which the parties demonstrated the economic feasibility of the proposed venture to the Soviet authorities. See *id.* art. 2. The joint venture agreement specified the areas of cooperation between partners in a joint venture and set forth a description of its business objectives and plans. See *id.* art. 7. The charter functioned as a certificate of incorporation and corporate by-laws, providing the rules for management and other internal matters of the joint enterprise. *Id.*

Finance.¹⁰⁴ Upon approval, the Ministry of Finance recorded the joint enterprise in a registration ledger, and issued a certificate of registration.¹⁰⁵ Soviet standards required joint enterprises to maintain accounting and statistical records in accordance with the Soviet methods.¹⁰⁶ A Soviet auditing organization could audit the enterprise.¹⁰⁷ A government body could also summarily dissolve a joint enterprise.¹⁰⁸

The Joint Venture Law theoretically afforded joint enterprises considerable freedom in controlling their economic activities within the territory of the U.S.S.R. Unlike most Soviet enterprises, joint enterprises theoretically were not subject to the central planning agencies and a myriad of other Soviet administrative agencies and ministries which unilaterally controlled virtually every detail of production, distribution, and sale of goods, commodities, and services within the country.¹⁰⁹ The Ministry of Finance and Ministry for External Economic Affairs (the two ministries with primary jurisdiction over joint ventures with foreign participants), however, had the authority to exercise, and in certain instances did exercise, significant control over many business activities of joint ventures, occasionally demanding compliance with Soviet economic and administrative law applying to state enterprises.¹¹⁰

Occasional demands to observe Soviet economic legislation designed exclusively for state enterprises functioning in a non-market economy notwithstanding, most East-West joint enterprises in the Soviet Union existed in a legal vacuum. Because joint enterprises generally operated largely outside the regulatory control of Soviet central planning organizations, they could freely negotiate prices for their products and services and sell them to whomever they wished.¹¹¹ Joint enterprises, however, were left on their own to obtain

¹⁰⁴ See *id.* art. 9.

¹⁰⁵ *Id.*

¹⁰⁶ See HOBES, *supra* note 1, § IX.E(8)–(9).

¹⁰⁷ See Decree No. 49, *supra* note 3, art. 45.

¹⁰⁸ See *id.* art. 51.

¹⁰⁹ See *id.* art. 23. Article 23 proclaims that no binding planning tasks will be issued to joint ventures and that joint ventures will plan their economic activities independently: "A joint enterprise shall independently work out and confirm the program for its economic activities. State agencies of the U.S.S.R. shall not establish binding planning tasks for a joint enterprise, and the sale of its products shall not be guaranteed." *Id.*

¹¹⁰ See Bost, *supra* note 80, at 591–93; W. Gary Vause, *Perestroika and Market Socialism: The Effects of Communism's Slow Thaw on East-West Economic Relations*, 9 NORTHWESTERN J. INT'L L. & BUS. 213, 247–48.

¹¹¹ See, e.g., Decree No. 49, *supra* note 3, art. 24.

raw materials and supplies, and often had to purchase supplies in foreign markets using their convertible currency reserves.¹¹² In practice, many joint ventures were at the mercy of the planners and regulators in the central and republican industrial ministries, which, if persuaded, could provide joint enterprises with locally produced supplies for payment in rubles. More importantly, domestic distribution and marketing of products and services produced or offered by these joint enterprises was complicated by the fact that most other Soviet producers and consumers were acting pursuant to a predetermined central plan which did not account for joint ventures with foreign firms and had no authority to deal directly with such joint ventures.¹¹³

The Joint Venture Law also endowed joint enterprises with all the features and rights of legal entities under Soviet law, including rights to do the following in the joint enterprise's own name: (i) conclude agreements; (ii) acquire property; (iii) incur debts and obligations; and (iv) appear as plaintiff or defendant in the courts of law or arbitration.¹¹⁴ This was significant for several reasons. First, because the joint enterprise form was unknown to Soviet jurisprudence heretofore, it was not clear whether it possessed the rights of an independent and self-sufficient quasi-private legal entity. Second, Soviet law placed a great emphasis on the legal capacity of entities to enter into valid contractual relationships in order to ensure that only "approved" state enterprises be permitted to engage in business transactions.¹¹⁵ Third, property rights of legal persons under Soviet law were similarly unclear as a result of Marxist ideological influences of the Marxist doctrine, and the joint enterprise's explicit grant of property rights was thus essential.¹¹⁶

Joint enterprises enjoyed preferential treatment with respect to taxation and customs duties. Generally, Joint Venture Law subjected a joint enterprise to a 30 percent tax rate applicable to its profits,

¹¹² See *id.* art. 23.

¹¹³ See HOBBER, *supra* note 1, § VI.A(2).

¹¹⁴ See Decree No. 49, *supra* note 3, art. 6.

¹¹⁵ See OLIMPIAD S. IOFFE, SOVIET CIVIL LAW 55 (1988) (discussing the inapplicability of absolute rights as applied to the legal capacity of a Soviet entity to enter into a contract and the consequent use of relative rights in Soviet civil law resulting in a peculiar approach to contract law under which "legal relations are possible exclusively between certain subjects," as selectively recognized by the state).

¹¹⁶ See generally Giuliani, *Joint Ventures in the USSR: Legal Personality, Enterprise and Ownership*, 1 INT'L CO. & COM. L. REV. 16 (1990) (source on file with the authors).

after permitted deductions.¹¹⁷ Joint Venture Law, however, imposed no tax on the joint enterprise during the first two years it declared profits.¹¹⁸ Furthermore, the U.S.S.R. Ministry of Finance could lower the tax rate and extend the tax holiday.¹¹⁹ A further 20 percent repatriation or withholding tax applied to after-tax profits of the western participant that were repatriated abroad.¹²⁰

Joint Venture Law allowed equipment, materials, and other property to be imported into the Soviet Union as part of the foreign participant's contribution to the statutory fund, without customs duties and import permits.¹²¹ Subsequent shipment of goods and property into and out of the Soviet Union required import/export permits.¹²² The amendments to the Joint Venture Decree, however, imposed little or no duty on the import of equipment and supplies necessary for the operation of a joint enterprise.¹²³ Joint enterprises could freely engage in foreign trade transactions subject to the export and import licensing regime and did not require special authorization then necessary for state enterprises.¹²⁴

Perhaps the most significant barrier to joint venture operations in the U.S.S.R. of that period was the difficulty in repatriation of profits by the western participant. This difficulty arose from the fact that Soviet currency was not freely convertible on the world's capital markets and foreign investors had no access to any official exchange facilities which would have permitted them to convert ruble earnings into foreign currencies.¹²⁵ The law stipulated that the foreign partners may transfer their distributed profits abroad in foreign currency¹²⁶; yet, in practice, such transfer was possible only if the joint enterprise generated convertible currency profits because the

¹¹⁷ See Decree No. 49, *supra* note 3, art. 36.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.* art. 41.

¹²¹ See *id.* art. 13.

¹²² See *id.* art. 24.

¹²³ See Decree No. 1405, *supra* note 87, art. 6.

¹²⁴ See HÖBER, *supra* note 1, § VI.E(1).

¹²⁵ See *id.* § III.D(2)-(3). Because the Soviet ruble was not a freely convertible currency, and did not have a determined market value until 1991, most Soviet foreign trade occurred either in standard commodities, such as oil and natural gas, or on the principle of bilateral balance. *Id.*

¹²⁶ See Decree No. 49, *supra* note 3, art. 32. "The transfer abroad in foreign currency of the amounts due to foreign participants as a result of the distribution of profits from enterprise activities shall be guaranteed to such foreign participants." *Id.*

Soviet ruble could not be freely converted into foreign currency.¹²⁷ Thus, joint enterprises faced the choice between generating convertible currency revenues through exports or convertible currency sales within the U.S.S.R. and engaging in generally inefficient counter-trade, compensation, and currency-pooling arrangements. Under the Joint Venture Law, profits had to be distributed to the participants in the joint enterprise in proportion to their ownership shares in the statutory charter fund.¹²⁸

As noted above, the principal shortcoming of the Joint Venture Law was that joint enterprises were artificial legal entities created specifically for foreign investment. Such entities were unprecedented in Soviet law and were not easily reconciled with other particularly ideological provisions of old Soviet law which remained on the books prior to the 1990-91 reforms.¹²⁹ The practical aspects of integrating essentially private, market-oriented entities with partial foreign ownership into the traditional Soviet economy posed managerial difficulties for foreign participants inexperienced in conducting business operations in a centrally planned economy.¹³⁰

Other problems of the Joint Venture Law related to the following bureaucratic obstacles imposed on joint enterprises which required:

¹²⁷ See HOBBER, *supra* note 1, § IX.G(1)-(2). A limited number of alternatives were thus available to foreign participants in Soviet joint enterprises in transferring their share of profits abroad, all dependent on the capability to generate convertible currency either in domestic Soviet markets or by selling abroad. *Id.* In addition, Article 25 of Decree No. 49 explicitly provided that "all currency expenditures of a joint enterprise, including the payment of profit and other amounts due foreign participants and specialists, must be ensured by the joint enterprise from receipts from the sale of its products on the foreign market." See generally Susan W. Tiefenbrun, *Joint Ventures in the U.S.S.R., Eastern Europe, and the People's Republic of China as of December 1989*, 21 N.Y.U. J. INT'L L. & POL. 667 (1989).

¹²⁸ See Decree No. 49, *supra* note 3, art. 31.

¹²⁹ Article 6 of Decree No. 49 stated that "joint enterprises shall be juridical persons according to Soviet legislation." *Id.* art. 6. Moreover, Article 15 of Decree No. 49 expressly subjected the property of joint enterprises to Soviet property law: "A joint enterprise shall exercise, in accordance with Soviet legislation, the possession, use, and disposition of its property. . . ." *Id.* art. 15. The principal ideological obstacles of Soviet law from the perspective of a foreign participant in a joint enterprise related to property rights (such as ownership of land, personal property, and major means of production) of Soviet persons (which included joint enterprises) and could be found in the Soviet constitution and other laws regulating property relations in a socialist, centrally-planned economy. See HOBBER, *supra* note 1, § IV.C(11)-(12). Under the U.S.S.R. Constitution, the primary category of ownership was socialist ownership—which in turn consisted of state ownership, collective farm and cooperative ownership, and trade union and other social organization ownership. See *id.* § V.C(1)-(15). Although personal ownership also existed, it was limited to things not encompassing business assets. *Id.* The ownership rights of joint enterprises under Soviet law were consequently very unclear. *Id.*

¹³⁰ See HOBBER, *supra* note 1, § VI.D(1)-(2).

1) approval of a Soviet partner; 2) a feasibility study;¹³¹ 3) a long and arduous registration process with bureaucrats in Moscow; and 4) hiring of Russian nationals for certain management positions and as the principal labor force.¹³² Furthermore, foreign trade regulations required export and import licensing for joint enterprises' operations outside the Soviet Union. In addition, currency and exchange controls effectively prevented a repatriation of profits in hard currency unless the joint enterprise was self-sufficient through export revenue.¹³³ The necessity of barter and other forms of countertrade often made the profit margins negligible.¹³⁴

Finally, the Joint Venture Law itself offered the foreign investor neither clear guidelines for permissibility of certain business operations under Soviet law nor significant investment guarantees.¹³⁵ Most importantly, joint enterprises did not offer the foreign investor the flexibility needed to acquire different types of property in the U.S.S.R., independently of Soviet organizations.¹³⁶ Foreign investors were not given the right to act in their own name in the Soviet economy and could invest in Soviet property or engage in business only through joint enterprises with local partners.

B. *Changes in the Soviet Foreign Investment Regime in 1990*

In 1990, the Soviets were determined to radically overhaul the legal scheme for foreign investment in an effort to replace the Joint Venture Law. The "Shatalin Plan,"¹³⁷ which called for a complete overhaul of the Soviet legal system in preparation for a free-fall into

¹³¹ Decree No. 49, *supra* note 3, art. 2.

¹³² *Id.* art. 47.

¹³³ See Tiefenbrun, *supra* note 127, at 682.

¹³⁴ Barter and countertrade transactions tend to be expensive because the goods received in trade require resale, and their value is diminished by commissions. See *Bartering with the Bolsheviks: A Guide to Countertrading with the Soviet Union*, 8 DICK. J. INT'L L. 269, 273 (1990).

¹³⁵ The Joint Venture Law could not provide a substitute for a well-developed, comprehensive domestic legal system considered desirable for a successful investment abroad. See *infra* notes 213-14 and accompanying text.

¹³⁶ Under the Joint Venture Law, investments could only be made in the form of proprietary interests in joint enterprises rather than securities or assets directly and required making such investments in conjunction with a Soviet partner, which had to maintain at least some minimal ownership interest in the investment.

¹³⁷ *Transition to the Market*, A Working Group formed by a joint decision of M.S. Gorbachev and B.N. Yeltsin, translated and printed by the Cultural Initiative Foundation (1990) (source on file with the authors); see Richard N. Dean, *Considering Business Opportunities in the Soviet Union in the 1990s*, 24 VAND. J. TRANSNAT'L L. 325, 327-39 (1990) (discussing various economic reform plans circulating in the late 1980s in the Soviet government, including the earlier Ryzhkov Plan, the Shatalin Plan and the resultant Gorbachev Plan).

market economics, however, was not adopted in its entirety. Its main tenets nonetheless gained considerable acceptance in the more liberal corners of the Soviet government. Some Soviet policymakers recognized that in order to accommodate foreign investors, the Soviet Union would need to replace the "economic" legislation applicable to state enterprises with domestic commercial laws capable of regulating a market-oriented economy.¹³⁸ Throughout 1990, more than twenty pieces of legislation concerning companies, privatization, property, currency, and pricing were passed.¹³⁹ Accordingly, the need for the Joint Venture Law diminished, and the Soviets were prepared to enact a general foreign investment regime akin to those in effect in most other jurisdictions with developing economies.¹⁴⁰ Rather than restricting the choice of an organizational vehicle for foreign investment to joint enterprises, the new Soviet foreign investment regime, as established in 1990, permitted investment in the U.S.S.R. in any form allowed by domestic law.¹⁴¹ This regime provided the general framework for making various types of invest-

¹³⁸ Creating, protecting, and enforcing property rights is thought to be an essential condition for a successful transition of planned economies to market economy. See *Building Free Market Economies in Central and Eastern Europe: Challenges and Realities*, The Institute of International Finance, Inc., Apr. 1990, at 34-35. To promote investor confidence in the Soviet market, the Soviet government thus understood the need for a solid legal and institutional framework to support economic reform. See generally David M. Kemme, *Economic Transition in Eastern Europe and the Soviet Union: Issues and Strategies*, Institute for East-West Security Studies, Occasional Paper No. 20 (1991).

¹³⁹ See generally Paul B. Stephan III, *The Restructuring of Soviet Commercial Law and Its Impact on International Business Transactions*, 24 GEO. WASH. J. INT'L L. & ECON. 89 (1990); see also *USSR Legal Materials*, COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. (1990) (contains the list and texts of all principal Soviet legislative enactments of the period); OSAKWE, *supra* note 77, at xxvi-xxvii.

¹⁴⁰ Most developing nations possess foreign investment regimes which do not purport to regulate all activities of companies with foreign investment but rather refer foreign investors with respect to most questions of their business operations to their domestic laws. See CLASEN, *supra* note 2, at 199-204. Their domestic jurisprudence generally accommodates private ownership of property and contains at least some rudimentary rules for the conduct of commercial transactions while their foreign investment laws, if any, generally address only the issues of the structure and permissibility of foreign investment in various sectors of their domestic economies. *Id.* The Soviet Union at the time, however, did not recognize private ownership and private enterprise unequivocally and had very little in the way of legal regulation of private business transactions. See generally David Winter, *Commerce and Commercial Law*, in 1 ENCYCLOPEDIA OF SOVIET LAW 132 (F.J.M. Feldbrugge ed., 1985). "Commercial law . . . does not exist as such and indeed commercial law does not exist as an independent branch of law in the system of Soviet law unlike the position under certain civil law systems." *Id.* at 134.

¹⁴¹ Although the authorization for foreign investment in the form of wholly-owned subsidiaries of foreign companies, branches, security acquisitions, purchases of assets, and various contractual activities in addition to joint ventures may have been purely theoretical in early

ments, governed the rights and liabilities of a foreign investor, and provided certain measures of investment protection.¹⁴²

The foreign investment regime in 1990 consisted of three laws: the Presidential Decree on Foreign Investment of October 26, 1990 (Presidential Foreign Investment Decree);¹⁴³ the Fundamentals of Law on Investment Activity in the U.S.S.R. of December 10, 1990 (Fundamentals);¹⁴⁴ and the Draft U.S.S.R. Law on Foreign Investment in the Soviet Union of October 17, 1990 (Draft Foreign Investment Law).¹⁴⁵ The Presidential Foreign Investment Decree proclaimed for the first time that foreign capital was welcome on Soviet soil in forms other than the joint enterprise—namely, wholly-owned foreign subsidiaries and mixed ownership companies.¹⁴⁶ While revolutionary in its scope, the Presidential Foreign Investment Decree could not be used by foreign investors in actual projects due to its brevity, broad language, and lack of implementation. The enactment on the Fundamentals of Law on Investment Activity in the U.S.S.R.¹⁴⁷ and the federal and republican versions of the Foreign Investment Law provided the needed specificity.¹⁴⁸

1. The Fundamentals

The Fundamentals, which became effective on January 1, 1991, were a comprehensive investment code that addressed the rights and abilities of both Soviet nationals and foreigners to invest in the Soviet Union.¹⁴⁹ The Fundamentals focused on paving the way for privatization of the Soviet economy, rather than installing a legal regime to govern foreign investments. These investment laws af-

1990 because of the lack of enabling legislation for companies, securities, and commercial transactions, the possibility for making such investments in the future signified a turning point in the history of Soviet foreign investment law. See OSAKWE, *supra* note 77, at 1.31.0–1.33.

¹⁴² See discussion *infra* parts III.B.1, III.B.2.

¹⁴³ Decree of the President of the U.S.S.R. On Foreign Investment in the U.S.S.R., Oct. 26, 1990, in 44 Ved. S'ezda Nar. Dep. SSSR Item 944 (1990), translated in 30 I.L.M. 927 (1991) [hereinafter Foreign Investment Decree] (Decree instructed other governmental entities to issue laws and regulations to implement the general policies of the Decree).

¹⁴⁴ Fundamentals of Legislation on Investment Activity in the U.S.S.R., Dec. 10, 1990, in 51 Ved. S'ezda Nar. Dep. SSSR Item 1109 (1990), translated in 30 I.L.M. 913 (1991) [hereinafter Fundamentals].

¹⁴⁵ Reprinted in 1 SOVIET BUS. L. REP., OCT. 1990, available in LEXIS, Nexis Library, RCBLR File.

¹⁴⁶ See Foreign Investment Decree, *supra* note 143, art. 2.

¹⁴⁷ See *supra* note 144 and accompanying text.

¹⁴⁸ See *infra* notes 220–21 and accompanying text.

¹⁴⁹ See Fundamentals, *supra* note 144, art. 4.

forded legal recognition to ownership interests in investments made in the Soviet Union¹⁵⁰ and guaranteed protection of foreign investment.¹⁵¹ The Fundamentals, however, suffered from the vague draftsmanship typical of all Soviet law-making, and thus failed to clarify many significant issues. To fill its gaps, the Fundamentals had to be considered in conjunction with, *inter alia*, the Joint Venture Law,¹⁵² the U.S.S.R. Law on Enterprises (Soviet Enterprise Law),¹⁵³ the Regulations on Joint Stock Companies and Limited Liability Companies (Soviet Company Law),¹⁵⁴ the U.S.S.R. Law on Ownership (Property Law or Soviet Property Law),¹⁵⁵ the U.S.S.R. Law on Currency Regulation,¹⁵⁶ and the U.S.S.R. Law on the Taxation of Enterprises, Associations, and Organizations.¹⁵⁷ Read together, these laws provided the foreign investor with more specificity regarding domestic commercial operations.

The Fundamentals granted foreign nationals the right to invest in all sectors of the Soviet economy.¹⁵⁸ There were two types of permitted investments: passive investments and active investments.¹⁵⁹ Passive investments included monetary funds, bank accounts, securities, leases, personal and intellectual property, and real property.¹⁶⁰ Active or capital investments included capital contributions to busi-

¹⁵⁰ *Id.* art. 1.

¹⁵¹ *Id.* art. 20.

¹⁵² See *supra* notes 72–136 and accompanying text.

¹⁵³ U.S.S.R. Law on Enterprises, June 4, 1990, translated in BUTLER, *supra* note 42, at 301–21 [hereinafter Soviet Enterprise Law].

¹⁵⁴ U.S.S.R. Council of Ministers Resolution No. 590, on the Regulations on Joint Stock Associations and Limited Liability Companies, June 19, 1990, in 15 *Sobr. Postan. SSSR* 333 (1990), translated in 30 *I.L.M.* 266 (1991) [hereinafter Soviet Company Law].

¹⁵⁵ U.S.S.R. Law on Property, Mar. 6, 1990, translated in BUTLER, *supra* note 42, at 269–81 [hereinafter Soviet Property Law]; cf. R.S.F.S.R. Law on Property (Ownership), Dec. 24, 1990, reprinted in *Ekon. i Zh.* No. 3, at 13 (Jan. 1991) (source on file with the authors); see also Viktor P. Mozolin, *On the Drafting of the Law on Ownership in the USSR under the Conditions of Radical Economic Reform*, 10 *Sov. Gos. i Pravo* 73–78 (1989) (source on file with the authors).

¹⁵⁶ U.S.S.R. Law on Currency Regulation, translated in BUTLER, *supra* note 42, at 341–53.

¹⁵⁷ U.S.S.R. Law on the Taxation of Enterprises, Associations, and Organizations, June 14, 1990, in HOBEL, *supra* note 1, § A.37.1.

¹⁵⁸ See Fundamentals, *supra* note 144, art. 1. Restrictions on investments in certain areas were not enumerated in the Fundamentals but instead were provided in other laws. Cf. R.S.F.S.R. Law on Foreign Investments in the R.S.F.S.R., art. 4, July 4, 1991, translated in 31 *I.L.M.* 397 (1992) [hereinafter Russian Foreign Investment Law]; see also *infra* note 396.

¹⁵⁹ Fundamentals, *supra* note 144, art. 1.

¹⁶⁰ The ownership of personal and real property under former Soviet law excluded land and natural resources, and was restricted to private entities at the all-Union level. See U.S.S.R. Constitution of 1977, *supra* note 46, art. 11 (declaring that all land in the U.S.S.R. territory is in the exclusive ownership of the state and extends to all bounties of the earth, including mineral resources, bodies of water, and forests. Consequently, most forms of commercial

ness entities.¹⁶¹ No provisions existed for the registration of companies with foreign ownership; other Soviet and republican laws subsequently addressed this issue. These early laws, though not fully developed, constituted liberal regulation of foreign investment.¹⁶²

An important aspect of the Fundamentals for foreign investors was the protection they provided for investments on the basis of national treatment.¹⁶³ Foreign investors were thus granted the same rights as Soviet nationals with respect to ownership, control, and disposition of their investments. If state agencies violated an investor's legal rights, a court of law or arbitration board had to grant compensation.¹⁶⁴ If the state body was unable to pay the awarded damages, the Supreme Soviet with jurisdiction over the particular agency was responsible for such payment.¹⁶⁵ Similarly, investments could not be nationalized or expropriated by the Soviet government without reimbursement payable to the foreign investor for the value of the investment it lost through such nationalization or expropriation.¹⁶⁶ The law also allowed for the voluntary insuring of investments.¹⁶⁷

The Fundamentals enhanced and clarified in some detail rights granted by the Presidential Decree, which confirmed the right of foreign investors to purchase securities issued by Soviet companies and to lease land and other natural resources.¹⁶⁸ Under the Presidential Decree, foreign investment could comprise 100 percent of an existing Soviet company's equity, and foreign companies could form wholly-owned subsidiaries.¹⁶⁹ Direct foreign investment could be made by both individuals and legal entities.¹⁷⁰ No regulations

transactions involving land and natural resources, including purchasing, selling, pledging and transferring, were legally impossible under Soviet law. *See generally* OSAKWE, *supra* note 77, at chs. 11 (discussing in detail constitutional and statutory limitations of Soviet law on private ownership of land and natural resources), 13 (discussing Soviet regulation of commercial development and exploitation of land and natural resources).

¹⁶¹ U.S.S.R. Constitution of 1977, *supra* note 46, art. 11.

¹⁶² Provisions relating to tax and regulatory schemes imposed on foreign investors in the U.S.S.R. were relatively benign in relation to other host countries where tax and regulatory burdens were considerably heavier. *See* Fundamentals, *supra* note 144, art. 11.

¹⁶³ *See id.* art. 23.

¹⁶⁴ *See id.* art. 20.

¹⁶⁵ *Id.*

¹⁶⁶ *See id.* art. 23.

¹⁶⁷ *Id.*

¹⁶⁸ *See* Decree of the President of the U.S.S.R. On Foreign Investments in the U.S.S.R. (Oct. 26, 1990), *reprinted in* IZVESTIYA, Oct. 26, 1990, art. 1 (source on file with the authors).

¹⁶⁹ *See id.* art. 2.

¹⁷⁰ *Id.*

existed at that time, however, to implement the Decree's provisions on wholly-owned foreign companies and branches.

2. Draft Foreign Investment Law

The Draft Foreign Investment Law¹⁷¹ applied specifically to foreign investors, whereas the Fundamentals governed all investments within the U.S.S.R. territory regardless of the investor's nationality.¹⁷² Unlike the Joint Venture Law, the Draft Foreign Investment Law expressly permitted foreign individuals—as opposed to legal entities—to participate in joint enterprises.¹⁷³ With regard to the objects of foreign investment, the Draft Foreign Investment Law provided for investment in industrial and other enterprises, including banks, buildings, securities, various property rights, and rights to the use of natural resources.¹⁷⁴ This explicit authorization to invest in the financial service industry was particularly important because under prior law, it was unclear whether foreigners could invest in Soviet banking, securities, and insurance organizations.

Some of the more important provisions of the Draft Foreign Investment Law vary somewhat from the provisions of the final law as passed in 1991.¹⁷⁵ Foreign investors were permitted to invest through the following: 1) the acquisition of shares in Soviet enterprises; 2) the creation of wholly foreign-owned new enterprises or branches; and 3) the acquisition of property, land-use rights, and Soviet securities.¹⁷⁶ In a departure from the Joint Venture Law, the Draft Foreign Investment Law permitted the creation of joint ventures with foreign investors in any form of business organization allowed by domestic law, including stock companies and limited liability associations.¹⁷⁷ Any type of business investment activity was allowed, except activities prohibited by law.¹⁷⁸ Engaging in restricted activities, as defined in the applicable laws, required a special license.¹⁷⁹

¹⁷¹ *Reprinted in Foreign Investment Law Key Component of Shift to Market Economy*, SOVIET BUS. L. REP., Oct. 1990, available in LEXIS, Nexis Library, RCBLR File [hereinafter Draft Law].

¹⁷² *See generally Foreign Investment Law Key Component of Shift to Market Economy*, SOVIET BUS. L. REP., Oct. 1990, available in LEXIS, Nexis Library, RCBLR File.

¹⁷³ Draft Law, *supra* note 171, art. 1.

¹⁷⁴ *Id.* art. 2.

¹⁷⁵ *See discussion infra* part III.C.

¹⁷⁶ Draft Law, *supra* note 171, art. 3.

¹⁷⁷ *Id.* art. 4.

¹⁷⁸ *Id.* art. 7.

¹⁷⁹ *Id.* (such as banking).

Registration of entities with foreign investment was subject to the law of the republic in which the investment was made.¹⁸⁰ This recognition of republican sovereignty also differed from the provisions of the Joint Venture Law, which initially required all-Union registration with the U.S.S.R. Ministry of Finance.¹⁸¹ The U.S.S.R. Ministry of Finance, however, still maintained a register of such companies.

Mixed-ownership companies with foreign participation of less than 50 percent could not invest in other Soviet companies.¹⁸² In addition, the percentage share of mixed-ownership joint enterprises in other Soviet entities could not exceed 50 percent of that entity's charter fund.¹⁸³ If a mixed-ownership company had less than 50 percent foreign equity participation, that company could not have subsidiaries.¹⁸⁴ These provisions did not survive in the enacted bill. As under the Joint Venture Law, mixed-ownership companies had to attain hard currency self-sufficiency.¹⁸⁵ Consortiums, on the other hand, had the ability to distribute ruble-earned dividends in hard currency.¹⁸⁶ Mixed-ownership companies, however, had an otherwise unrestricted right to repatriate earnings by transferring dividends abroad.¹⁸⁷ Foreign investors were given the right to reinvest their profits in the Soviet Union.¹⁸⁸ Moreover, foreign investors could open and maintain Soviet bank accounts, but they could not transfer rubles abroad.¹⁸⁹ Foreign investors were also given the right to buy convertible currency at currency auctions.¹⁹⁰

The Draft Foreign Investment Law recognized mixed-ownership companies' freedom to hire labor subject to U.S.S.R. labor law.¹⁹¹ Individual employment contracts were enforceable consistent with Soviet labor codes.¹⁹² Mixed-ownership companies were also given freedom to set their own prices for production and were not re-

¹⁸⁰ *Id.* art. 8.

¹⁸¹ Decree No. 49, *supra* note 3, art. 9.

¹⁸² Draft Law, *supra* note 171, art. 9.

¹⁸³ *Id.*

¹⁸⁴ *Id.*

¹⁸⁵ *Id.* art. 11. Practically, this meant that such companies could not distribute a dividend to its participants or shareholders in hard currency if it was earned in rubles. Orientation toward export sales was thus important for the foreign investor in the Soviet Union who was not content with the reinvestment of rubles and desired immediate repatriation of profits in convertible currency.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.* art. 12.

¹⁸⁸ *Id.* art. 13.

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.* art. 15.

¹⁹² *Id.* art. 15.

quired to comply with the pricing directives of the Soviet central planning agencies.¹⁹³

The Draft Foreign Investment Law included provisions governing certain import and export transactions.¹⁹⁴ No license was required to import materials for a mixed-ownership company's own needs, or for the export of a mixed-ownership company's own production.¹⁹⁵ No customs duties were imposed on the import of property brought into the U.S.S.R. as a company's initial capital.¹⁹⁶

Disputes involving mixed-ownership companies were governed by Soviet courts and the Gosarbitrazh, the state arbitration body.¹⁹⁷ The leasing of property by foreign investors or mixed-ownership companies had to conform to both U.S.S.R. and republican leasing law.¹⁹⁸ If a foreign investor or mixed-ownership company wished to lease property valued at R100,000,000 or more, special permission was needed from the state ministry with jurisdiction over the property.¹⁹⁹

The Draft Foreign Investment Law also provided a new definition of joint enterprise. Any juridical entity, regardless of its corporate form, created under Soviet law, and in which Soviet and foreign partners participated, was considered a joint enterprise.²⁰⁰ If a joint enterprise had capitalization exceeding R100,000,000, it could only be created by the Soviet party with the permission of the republican or U.S.S.R. Council of Ministers.²⁰¹ The specific organizational structure of mixed-ownership companies was governed by the relevant provisions of the Enterprise Law and the Company Law.²⁰² The Draft Foreign Investment Law defined a "foreign enterprise" as an entity in which foreign participation constitutes 100 percent of the company's equity.²⁰³

The 1990 foreign investment regime introduced several improvements over the old Soviet joint venture regime. First and foremost,

¹⁹³ *Id.* art. 17.

¹⁹⁴ *Id.* arts. 18–19.

¹⁹⁵ *Id.* art. 18.

¹⁹⁶ *Id.* art. 19.

¹⁹⁷ *Id.* art. 25.

¹⁹⁸ *Id.* art. 29.

¹⁹⁹ *Id.*

²⁰⁰ *Id.* art. 32.

²⁰¹ *Id.* art. 33.

²⁰² Law on Enterprises in the U.S.S.R., June 4, 1990, art. 2, *translated in* BUTLER, *supra* note 42, at 303–21 [hereinafter Enterprise Law]; Law on the General Principles of Entrepreneurship of Citizens in the U.S.S.R., Apr. 11, 1991, *translated in* W.E. BUTLER, BASIC DOCUMENTS ON THE SOVIET LEGAL SYSTEM 225–32 (1992).

²⁰³ Draft Law, *supra* note 171, art. 39.

foreign investors had much greater flexibility in structuring their investment in the Soviet Union. Instead of a cumbersome and unorthodox form of the joint enterprise, foreign investors could choose various organizational forms of doing business in the U.S.S.R., including a public corporation, a private company, or a general or limited partnership. The new Soviet rules no longer limited maximum percentage of foreign ownership. Foreign investors could establish or acquire wholly-owned companies as subsidiaries or branches.²⁰⁴ Rather than being limited to joint enterprises,²⁰⁵ foreign nationals wishing to establish joint ventures in the U.S.S.R. could invest through purchasing a partial interest in any domestic Soviet business entity allowed by law or establish a new joint venture company.²⁰⁶

Second, the new regime was generally more permissive and, like foreign investment regimes of many other capital-importing jurisdictions,²⁰⁷ only addressed issues which were not otherwise covered by domestic legislation.²⁰⁸ All questions of business organization and operations were left for the domestic company laws that applied equally to Soviet and non-Soviet shareholders or partners.²⁰⁹ This new spirit of permissiveness translated into the removal of several restrictions imposed on joint ventures. One such restriction was the requirement of special government approval for the Soviet participant to enter into a joint enterprise with western participation.²¹⁰

Third, by reanimating the traditional forms of business organization, most of which clearly had been derived from pre-revolutionary Russian and western law, the new foreign investment regime exerted a stabilizing influence on the legal status of foreign investment in the U.S.S.R. As noted above, the concept of a joint enterprise was

²⁰⁴ Limits on foreign ownership of joint enterprises under the original Joint Venture Law was 49 percent, later amended to reach as much as 99 percent. See *supra* notes 72-73 and accompanying text. The ability to form wholly-owned subsidiaries and branches was of significance because many Russian enterprises were primarily interested in forming joint enterprises with foreign companies and looked unfavorably on contractual joint venture or cooperation arrangements due to certain benefits they derived from the provisions of the Soviet Joint Venture Law. See HOBES, *supra* note 1, § IV.B(2)-(3).

²⁰⁵ Joint enterprises were then still technically possible to form but were no longer actively encouraged by the Soviet government.

²⁰⁶ Draft Law, *supra* note 171, art. 32.

²⁰⁷ See, e.g., William H. Barringer, *Legal Aspects of Foreign Investment in Developing Countries*, in A LAWYER'S GUIDE TO INTERNATIONAL BUSINESS TRANSACTIONS 372 (Part IV) (2d ed.).

²⁰⁸ See *supra* note 110 and accompanying text.

²⁰⁹ See *supra* note 158 and accompanying text.

²¹⁰ See Decree No. 1405, *supra* note 87, art. 35.

quite alien and artificial in both Soviet and Russian law.²¹¹ Consequently, joint enterprises in general, and especially those with foreign participation, did not neatly fit into previously-defined categories. To add to the confusion, all Soviet laws prior to the Joint Venture Law and some laws following its enactment did not specifically reference the joint enterprise. Thus, a guessing game arose whether a particular joint enterprise was to be included among "Soviet enterprises and organizations," the standard phrase appearing in legislation of that time.²¹²

The foreign investment regime of this period also suffered from many legislative and structural shortcomings. Although the organizational forms for foreign investment were substantially expanded and perfected in comparison with the preceding regimes, the Soviet foreign investment regime still exhibited many inconsistencies, ambiguities, and a lack of implementing regulations.²¹³ The new reformist legislation was specifically enacted to stimulate domestic and foreign investment, largely overriding the ideological obstacles to private property and private enterprise. The old laws, however, constituting the majority of Soviet private civil law, were not completely harmonized with the new legislation.²¹⁴ As a result, uncertainty surrounding the status of foreign investment in the yet unreformed Soviet economy was prevalent. Moreover, the promise of economic

²¹¹ See Edward H. Lieberman et al., *Investment in the Soviet Union and in Hungary: A Comparison of the New Soviet and Hungarian Investment and Tax Laws*, 23 GEO. WASH. J. INT'L L. & ECON. 1, 13-14 (1989) ("The Soviet joint venture law is a classic example of the enclave model for Western equity investment in a socialist country."). Even during NEP, Soviet Russia chose to employ the corporate model for both domestic and foreign investment in the private sector of its economy by permitting the creation of joint stock companies through the enactment of the 1927 Joint Stock Company Law. See G. Crespi Reghizzi, *Corporations*, in ENCYCLOPEDIA OF SOVIET LAW 196 (F.J.M. Feldbrugge ed., 1985).

²¹² See, e.g., Arbess, *supra* note 80, at 413.

²¹³ I BIRENBAUM & RACKLIN, BUSINESS VENTURES IN EASTERN EUROPE AND SOVIET UNION: THE EMERGING LEGAL FRAMEWORK FOR FOREIGN INVESTMENT 215-20 (1991).

²¹⁴ *Id.* One principal effort of Soviet legislators to integrate and codify civil private law was in fact partially successful. This was the Fundamentals of Civil Legislation of the U.S.S.R. and the Union Republics of May 31, 1991. See Fundamentals, *supra* note 144. Although it was scheduled to enter into force in 1992, it never did because of the general repeal by the Russian Federation of all Soviet legislation in its territory. See George W. Carey, *Five Years Later: Evaluating Foreign Investment Experience in the Former USSR*, in LEGAL AND PRACTICAL ASPECTS OF DOING BUSINESS IN THE SOVIET REPUBLICS, at 57-58 (PLI Handbook Series No. 604, 1992). Subsequently, the Russian parliament temporarily brought the Fundamentals of Civil Legislation back into force in Russia until the Russian Civil Code was amended. See Vratislav Pechota, *Russian Federation Reaches Back to 1991 USSR Fundamentals of Civil Law*, 3 COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. 5-6 (Aug./Sept. 1992).

reforms initiated half-heartedly by Gorbachev's administration was never fulfilled, failing to provide the essential requirement of an adequate infrastructure for foreign investment.²¹⁵ It becomes clear that while Gorbachev's administration propagated some of the milder versions of market reform, neither he nor his government was fully prepared to follow up with further reforms.²¹⁶ For example, legislative reforms in industry and agriculture, although hotly debated in the press, were minimally implemented.²¹⁷ Gorbachev's insistence on retaining the authority of the central government and monopoly of the Communist party made such reforms impossible. Gorbachev's tacit resistance through political maneuvering between the conservative and liberal elements in the government neither prevented him from losing power in late 1991 nor prevented the abolishment of the central Soviet domination of the republics constituting the Union.²¹⁸

It should be noted that the U.S.S.R. Foreign Investment Law was enacted in its final form on July 4, 1991. Subsequently, the Russian Federation promulgated its own version of the law on foreign investment.²¹⁹ The U.S.S.R. Foreign Investment Law, however, provided an additional layer of regulation on foreign investments in the territory of the Russian Soviet Federal Socialist Republic (R.S.F.S.R. and, after 1991, the Russian Federation) and other Soviet republics until the break-up of the Union.²²⁰ The Russian Foreign Investment Law then became the sole source of legal regulation of foreign investment in the Russian Federation.²²¹

²¹⁵ See, e.g., *The Soviet Economy: The Hard Road from Communism to Capitalism*, ECONOMIST, Nov. 18, 1989, at 22.

²¹⁶ J. William Middendorf II, *Rising Tide of Realities*, WASH. TIMES, Feb. 12, 1991, at 91.

²¹⁷ See Dean, *supra* note 137, at 327-30; The Economist Intelligence Unit, *Commonwealth of Independent States: Country Report* 46-53 (1992) (source on file with the authors).

²¹⁸ See, e.g., *Yeltsin Solidifies Control over Key Soviet Ministries*, Eastern Eur. Rep. (BNA) (Jan. 6, 1992), available in LEXIS, BNA Library, EERPT File.

²¹⁹ See *supra* note 158 and accompanying text.

²²⁰ The name Russian Soviet Federal Socialist Republic is no longer used due to the dissolution of the Soviet Union. It is now referred to as the "Russian Federation," the "Russian Republic," or "Russia." This article will make occasional references to R.S.F.S.R., as the term appears in the text of the Russian Foreign Investment Law and other legislation and regulations drafted during the existence of the Soviet Union. For further discussion of the relations between the republics vis-a-vis the old Union and the new Commonwealth, see discussion *supra* part III.A.

²²¹ See Declaration on the State Sovereignty of the Russian Soviet Federated Socialist Republic, June 12, 1992, ¶ 5, translated in BUTLER, *supra* note 42, at 139-41 (1991).

C. *Russian Foreign Investment Law of 1991*

In order to attract foreign capital, technology, and know-how, the R.S.F.S.R. Supreme Soviet enacted the Law on Foreign Investments on July 4, 1991, following the enactment of a similar law on the all-Union level.²²² The law establishes a comprehensive regime within which foreign investors can operate in the territory of the Russian Federation with relative ease and unprecedented flexibility. The law suffers, however, from many legislative drafting ills because it is couched in the typically imprecise and occasionally ambiguous language of former Soviet lawmakers.²²³ Interested parties, therefore, must read the law in conjunction with other Russian legislation on taxation, banking, stock companies and enterprises, pledges, personal property, land and natural resources regulation, and labor and other recent enactments in the area of commercial law.²²⁴ Former Soviet legislation generally has lost its force in the territory of Russia; however, certain former Soviet laws and regulations may still be relevant to the Russian foreign investment regime insofar as Russian domestic law presently lacks such substantive laws and the former Soviet law does not conflict with any existing Russian law. Thus, the former Soviet law and jurisprudence should be considered

²²² Russian Foreign Investment Law, *supra* note 158, art. 4. Provisions of the U.S.S.R. Fundamentals of Legislation on Foreign Investments are very similar to the Russian Foreign Investment Law. U.S.S.R. Fundamentals of Legislation on Foreign Investments, July 5, 1991, translated in FBIS-SU, Aug. 2, 1991 at 15 [hereinafter Soviet Foreign Investment Law]. Whenever relevant to the analysis, the provisions of the Soviet Foreign Investment Law will be referred to because of its significance in former Soviet republics other than the Russian Federation, some of which have adopted the Soviet Foreign Investment Law with little or no change as their own foreign investment law. The need for foreign capital in Russia is indeed drastic, and the statistical comparison with the previous Soviet foreign investment regime does not yet yield material improvement in the capital inflow. See *Russia: Foreign Investment Levels Still Relatively Low*, Reuter Textline, Oct. 14, 1992, available in LEXIS, Nexis Library, Reuter File (reporting that the Russian Vice President Shokhin announced that the annual inflow of foreign investment into the Russian economy was around \$800 million). During the first six months of 1992, sixty to seventy fully owned subsidiaries and joint venture companies were registered every month, most of which represented relatively small investments which sometimes barely exceeded the low statutory capitalization requirements. See *Business Outlook: Russia*, BUSINESS EASTERN EUROPE, Aug. 31, 1992, at 426, available in LEXIS, Europe Library, Bueeur File. By the end of 1991, about 3,000 joint ventures with foreign capital were registered, representing over \$2 billion of foreign investment. See *Russia: Joint Ventures—92 Report*, Reuter Textline, Apr. 19, 1992, available in LEXIS, Nexis Library, Reuter File.

²²³ See, e.g., John J. Stephan, *U.S. Perspective on the Legal Environment for Foreign Investment in Russia*, in LEGAL AND PRACTICAL ASPECTS OF DOING BUSINESS IN THE SOVIET REPUBLICS, at 31 (PLI Handbook Series No. 604, 1992) (pointing out certain examples of outright inconsistency in the Russian legislation) [hereinafter *U.S. Perspective*].

²²⁴ Russian Foreign Investment Law, *supra* note 158, art. 5.

as purely transitional until such time as the Russian government has enacted its own laws in those areas.²²⁵

Provisions of the Russian Foreign Investment Law, in contrast to the Soviet Foreign Investment Law, generally do not require specific implementation through decrees and regulations on either the republican or local level.²²⁶ Despite some potential difficulties with interpretation and enforcement, the Law on Foreign Investments in the R.S.F.S.R. is the first such legislation addressing itself specifically to foreign investment in Russia. Therefore, as a self-implementing statute, the law should provide the necessary fundamentals for the Russian foreign investment regime.

1. Definition and Types of Foreign Investment

The law defines foreign investment as all types of property contributed by foreign investors into entrepreneurial and other activities for the purpose of deriving profit.²²⁷ The definition of an eligible investor has been expanded in the final version of the law.²²⁸ Foreign investors in Russia now include legal entities of any kind with the power to make investments under domestic law, physical persons registered to do business in their domicile, and states and international organizations.²²⁹ Foreign investors may participate in any objects of investment not prohibited by law, including capital and operational funds of enterprises, securities, special purpose money deposits, scientific-technical production, rights to intellectual property, and all other property rights.²³⁰ This terminology appears to manifest the legislative intent to be as liberal as possible in order to accommodate various forms of foreign investment.

Foreign investment may be carried out through any of the following methods: (i) ownership of shares of stock or other equity interests in Russian enterprises; (ii) ownership of Russian enterprises or subsidiaries wholly owned by foreign investors and Russian branches

²²⁵ See *U.S. Perspective*, *supra* note 223, at 30–32.

²²⁶ *Id.*

²²⁷ See Russian Foreign Investment Law, *supra* note 158, art. 2. Significantly, the law regulates both enterprises with foreign investment and foreign investors—participants in such enterprises or direct actors in the Russian economy without the use of any organizational vehicles formed under Russian law. See *id.* art. 1.

²²⁸ By way of comparison, the Soviet Foreign Investment Law allowed investment in the U.S.S.R. by foreign corporations, citizens, associations, states, and international organizations. See Soviet Foreign Investment Law, *supra* note 222, art. 2.

²²⁹ *Id.* art. 1.

²³⁰ *Id.* art. 4.

and agencies of foreign legal entities; (iii) acquisition of assets of enterprises, buildings, facilities, securities, and other property; (iv) acquisition of lease and use rights to land and natural resources in Russia; and (v) any other activity not prohibited by Russian law, including lending, deposit-taking, and leasing activities.²³¹ Thus, the law appears to contemplate all basic types of asset and stock-based purchase transactions within the range of permissible investment activities.²³² If anything, the law is somewhat overbroad because it includes commercial lending activity, which western law would not typically categorize as capital investment activity *per se*.

2. Property Rights

The Russian Foreign Investment Law reaffirms a broad range of property rights which can be possessed by an enterprise with foreign investment. For example, it specifically provides for the right to use or to lease land and natural resources which is already granted by Russian land, property, and leasing laws.²³³ The Russian Foreign Investment Law also adds certain approval and regulatory requirements related to ownership or possession of certain property. Any lease of state property of the Russian Federation valued at over R100 million will need the consent of the supervisory state agency.²³⁴ Moreover, concessions to develop, explore, and exploit natural re-

²³¹ *Id.* art. 3. A plethora of other Russian laws affect Russian companies, with and without foreign participation, directly and indirectly. Among them are: the tax laws (the U.S.S.R. Enterprise Tax Law as modified by relevant R.S.F.S.R. tax legislation), anti-monopoly law, labor law, banking law, bankruptcy law, securities regulations laws, pledge law, commercial paper law, privatization law, and land and property laws. The Fundamentals, *supra* note 144, essentially the Soviet Civil Code, were extensively amended recently and may provide a useful reference resource until the Russian Republic amends its own civil code, the R.S.F.S.R. Civil Code. A complete list of relevant Russian laws, decrees and resolutions is difficult to procure because bills are passed rapidly without timely publication or disbursement to western libraries.

²³² The Soviet version of the law, by contrast, stated that certain territorial limitations may be placed on the activities of foreign investors in the interests of national security. Such restrictions could be placed by the laws of the U.S.S.R. and the republics. *See* Soviet Foreign Investment Law, *supra* note 222, art. 7.

²³³ *See id.* arts. 6, 38. The following laws currently govern property relations in the Russian Federation: R.S.F.S.R. Civil Code (particularly Chapter 27, Leases of Property, articles 275–294), R.S.F.S.R. Law on Property, 30 Ved. S'ezda Nar. Dep. RSFSR, Item 416 (1990), U.S.S.R. Supreme Soviet Decree on Lease and Lease Relationships in the U.S.S.R., 15 Ved. Verkh. Sov. SSSR, Item 105 (1989), and the U.S.S.R. Fundamentals of Civil Legislation (sources on file with the authors); *see also* Randy Bregman & Dorothy C. Lawrence, *New Developments in Soviet Property Law*, 28 COLUM. J. TRANSNAT'L L. 189 (1990).

²³⁴ *See* Russian Foreign Investment Law, *supra* note 158, art. 39.

sources may be granted by foreign investors pursuant to a variety of newly drafted laws.²³⁵ Protection and utilization of intellectual property rights of enterprises with foreign investment is to be carried out in accordance with Russian law.²³⁶ In fact, a wide spectrum of property rights held by enterprises with foreign investment require special regulatory or administrative permissions and consents.²³⁷

Nevertheless, the Russian Foreign Investment Law firmly establishes the presumption that foreign investors are entitled to ownership of a wide range of property rights in Russia, which they can exercise in compliance with all applicable Russian legislation. This is a significant accomplishment for Russian jurisprudence because under the Soviet regime, the status of foreign persons, particularly with respect to their property rights in the U.S.S.R., never was made clear.²³⁸ In addition, the concept of private property, as it applies both to Russian and foreign persons, has finally become ingrained in the Russian law of property by the removal from Russian law of Marxist-Leninist ideological impediments to private ownership of the means of production.²³⁹

3. Creation and Forms of Foreign Investment Vehicles

Enterprises with foreign investment may be created and may exist in the territory of the Russian Republic in the form of stock associations and other business associations and partnerships provided for

²³⁵ See *id.* art. 40.

²³⁶ See *id.* art. 32. Some of the new legislative developments in the copyright, trademark and patent laws, however, have taken place on the former all-Union level only and have not yet been adopted in Russia. For discussion of the current state of Soviet intellectual property law and protection, see generally William G. Frenkel & Jeffrey Sperber, *From Borscht to Bits: Transfers of Technology and Industrial Property to the Soviet Union*, 4 DEPAUL BUS. L. J. 3 (1991).

²³⁷ One example of the necessity to comply with additional regulatory regimes will be real estate development, which requires approval of municipal authorities and compliance with the R.S.F.S.R. Land Code and local zoning regulations.

²³⁸ See *East-West Joint Ventures: Lessons From Past Soviet-Western Joint Ventures and Projections for Future Deals with the C.I.S.*, 20 DENV. J. INT'L L. & POL. 439, 446-47 (1992) [hereinafter *East-West Joint Ventures*].

²³⁹ The Russian Law on Property of December 24, 1990 unequivocally recognizes the right of persons to own any and all types of property, including land. See Law on Ownership in the R.S.F.S.R., Dec. 24, 1990, translated in W.E. BUTLER, COLLECTED LEGISLATION OF RUSSIA III.1-2, 3-19 [hereinafter Russian Property Law]. Similarly, it recognizes property rights of legal entities, including enterprises with foreign investment or joint enterprises. See *id.* arts. 14-16. Furthermore, it guarantees state protection of private property and permits owners, at their own discretion, to possess, use, and dispose of their property. See *id.* art. 2; see generally OSAKWE, *supra* note 77, at 11-35.

by Russian legislation.²⁴⁰ The Russian Law on Enterprises specifies the forms of business enterprises which may be created under Russian law, including stock associations, general and limited partnerships, and sole proprietorships.²⁴¹

The following three generic types of foreign investment vehicles are permitted under Russian law: (1) joint venture or mixed ownership companies; (2) wholly foreign-owned foreign companies; and (3) branches of foreign legal entities.²⁴² Such enterprises may be created through the formation of a new entity, through the acquisition by a foreign investor of an equity share in an existing Russian enterprise, or through the acquisition of a Russian enterprise in its entirety.²⁴³ New entities are to be formed in accordance with the Russian Law on Enterprises,²⁴⁴ the Russian Company Law,²⁴⁵ and Russian partnership law, which still awaits enactment through the revision of the Civil Code.²⁴⁶ Specific procedures and regulations for the issuance and acquisition of certain types of enterprises and their securities by foreign investors are expected to be issued under the Russian Foreign Investment Law.²⁴⁷

A joint venture in the Russian Federation may be established in any legal form permissible under Russian law; the choice of the form of business organization is left to the founders of the joint venture.²⁴⁸ The founders, therefore, may choose a contractual joint venture or an entity (equity) joint venture in the form of a mixed-ownership stock association or partnership.²⁴⁹ Although the joint enterprise

²⁴⁰ Law on Enterprises and Entrepreneurial Activity (Dec. 25, 1990), *translated in* W.E. BUTLER, COLLECTED LEGISLATION OF RUSSIA V.1-3, 1-23 (1992) [hereinafter Russian Enterprise Law]. The Russian Enterprise Law was preceded by its all-Union counterpart, the U.S.S.R. Law on Enterprises. *See* Soviet Enterprise Law, *supra* note 153.

²⁴¹ *See* Russian Enterprise Law, *supra* note 240, arts. 9-10.

²⁴² Russian Foreign Investment Law, *supra* note 158, art. 3. The Soviet Foreign Investment Law also anticipated all the major organizational vehicles of investment, such as formation of joint enterprises, creation of wholly-owned subsidiaries, acquisition of shares in existing enterprises, purchase of rights to the use of the land and other natural resources, and other forms of investment determined by contractual agreements. *See* Soviet Foreign Investment Law, *supra* note 222, art. 3.

²⁴³ *See* Russian Foreign Investment Law, *supra* note 158, art. 3; *see generally* BIRENBAUM & RACKLIN, *supra* note 213, § 2.04.

²⁴⁴ *See supra* note 240.

²⁴⁵ *See infra* note 252.

²⁴⁶ Unlike stock associations, Russian partnerships have been authorized only in principle without any enabling law.

²⁴⁷ *See* Russian Foreign Investment Law, *supra* note 158.

²⁴⁸ *See* Carey, *supra* note 214, at 60. "The Russian Federation does not have a joint venture law; it treats the joint venture arrangement as an agreement among the business partners that creates one of the specific business forms authorized by law." *Id.*

²⁴⁹ *Id.*

could still be formed under the former Soviet law in other former Soviet republics,²⁵⁰ it clearly cannot be formed under Russian law because the form of a joint enterprise is not recognized by the Russian Enterprise Law.²⁵¹ A subsidiary wholly owned by foreign shareholders may also be formed as a Russian stock association under the Russian Company Law.²⁵² A Russian branch of a foreign company does not require the creation of any entity under Russian law and, at present, it is not regulated by any enabling Russian law other than the Russian Foreign Investment Law.²⁵³

a. *Stock Companies*

For many legal and practical reasons, the stock company form is popular with foreign as well as domestic investors. Joint enterprises, however, are rarely formed in the former Soviet republics and can no longer be legally formed in the Russian Republic.²⁵⁴ The requirements for formation, registration, and operations of a stock company in the Russian Republic are primarily governed by its company law—whether the stock company exists solely with Russian shareholders, foreign shareholders, or a combination of both.²⁵⁵ The rights and obligations of foreign shareholders, however, are additionally governed by the Russian Foreign Investment Law.²⁵⁶

Under former Soviet law, pursuant to the U.S.S.R. Regulations on Joint Stock Associations and Limited Liability Associations (Soviet Company Law),²⁵⁷ which later gave rise to the Russian Company Law, natural persons and legal entities could organize business companies in the form of joint stock associations (*aktzionernye obschestva*)

²⁵⁰ See Soviet Enterprise Law, *supra* note 153, art. 2.

²⁵¹ See Russian Enterprise Law, *supra* note 240, arts. 6–15; see also *Russian Republic No Longer Registering Entities Structured Under Union Laws*, E. Eur. Rep. (BNA) No. 2, at 62 (Nov. 11, 1991), available in LEXIS, BNA Library, EERPT File.

²⁵² See R.S.F.S.R. Statute on Joint-Stock Societies, Dec. 25, 1990, art. 11, translated in W.E. BUTLER, COLLECTED LEGISLATION OF RUSSIA V.1–3, 27–43 (1992) [hereinafter Russian Company Law]; Russian Foreign Investment Law, *supra* note 158, art. 12.

²⁵³ See Russian Foreign Investment Law, *supra* note 158, art. 12.

²⁵⁴ This is primarily because the Russian Enterprise Law does not contemplate the organizational form of the joint enterprise as the Soviet law formerly did, and the status of already existing joint enterprises registered under former Soviet law is somewhat precarious in today's Russia. See Holland & Langer, *Ways to do Business in the Soviet Union*, 2 SOVIET LAW: THE BOTTOM LINE (Summer 1991) (source on file with the authors).

²⁵⁵ See Russian Company Law, *supra* note 252, art. 1.

²⁵⁶ Specifics of forming Russian joint venture companies with foreign shareholders and Russian subsidiaries wholly-owned by foreign shareholders are discussed below in part C.3.b.

²⁵⁷ U.S.S.R. Statute on Joint-Stock Societies and Limited Responsibility Societies, June 19, 1990, translated in BUTLER, *supra* note 42, at 323–43; see generally William G. Frenkel, *Soviet Company Law—An Overview*, 5 INT'L CO. & COM. L. REV. 153 (1991).

and limited liability associations (*obschestva s ogranichennoi otvetstvennostyu*).²⁵⁸ The Soviet Company Law stated clearly that individuals may be participants or shareholders and contribute their capital to the company's charter fund.²⁵⁹ Foreign investors were not dealt with specifically in the Soviet Company Law but instead were regulated by legislation on foreign investments.²⁶⁰ The Russian Foreign Investment Law, as well as its all-Union counterpart, explicitly permits foreigners to own shares in Russian companies and to be their founders.²⁶¹

With the demise of the Soviet Union, the Soviet Company Law is inapplicable to Russian companies, and the Russian Law on Stock Associations (Russian Company Law)²⁶² governs the creation of a stock company, the rights and obligations of its shareholders, its capital and management structure, and other matters of operation and dissolution of stock companies.²⁶³ This law is functionally similar to the western European company laws and, to a greater extent than the Soviet Company Law, to the U.S. state corporation laws. The Russian Company Law is of primary importance to the western investor in all legal and operational questions of making investments through Russian stock companies.

A stock association is defined by the Russian Company Law as "a company created on the basis of a voluntary agreement by legal entities and physical persons (including foreign ones) who have combined their assets through the issue of shares of stock for the purpose of satisfying common requirements and realizing profit."²⁶⁴ A Russian company may carry out any type of business activity not prohibited by R.S.F.S.R. legislation, except activities involving defense-related industries, rare and precious metals, raw materials, and timber and furs.²⁶⁵ The permission of the R.S.F.S.R. Council of Ministers is required to carry out their business activities.²⁶⁶ A Russian company must maintain an official company name, a registered trademark, and a company seal bearing such company's name and trademark.²⁶⁷

²⁵⁸ See Soviet Company Law, *supra* note 154, art. 1.

²⁵⁹ *Id.*

²⁶⁰ *Id.*

²⁶¹ See Russian Foreign Investment Law, *supra* note 158, art. 3.

²⁶² Russian Company Law, *supra* note 252.

²⁶³ See generally William G. Frenkel, *Russian Company Law: Analysis and Commentary*, 4 INT'L CO. & COM. L. REV. 149 (1992) (source on file with the authors).

²⁶⁴ Russian Company Law, *supra* note 252, art. 1.

²⁶⁵ See *id.* art. 2.

²⁶⁶ *Id.*

²⁶⁷ *Id.* art. 4.

The Russian Company Law states that "a company shall enjoy full business independence in determining the form of its management, and shall make its own decisions with respect to operations, marketing, pricing, employee compensation, and distribution of net profits."²⁶⁸ In contrast to Soviet law, however, the Russian Company Law appears to repudiate the traditional Soviet *ultra vires* doctrine.²⁶⁹ Thus, company transactions not specified in the company charter or exceeding its scope may still be valid, if not prohibited by current legislation.²⁷⁰

The Russian Company Law, in contrast to Soviet Company Law, does not differentiate between stock associations and limited liability associations. The only corporate business form under Russian law is the "stock company."²⁷¹ All advantages of the corporate form, including limited liability, are granted to the shareholders in Russian companies. Shareholders are liable for the company's debts and obligations only within the limit of their respective contributions to its share capital.²⁷² Russian law, however, does distinguish between "open" and "closed" stock associations.²⁷³ An open stock association is essentially a public company or a publicly held corporation, where no shareholder consent is necessary to transfer stock.²⁷⁴ A closed stock association is a privately held company or a closely-held corporation, where the consent of a majority of its shareholders is generally needed to effectuate a valid stock transfer.²⁷⁵

b. Joint Venture and Wholly-Foreign-Owned Companies

As creatures of Russian law, joint venture companies and wholly-owned subsidiaries of foreign companies, termed "enterprises with foreign investments" in the Russian Foreign Investment Law, must be formed by executing certain foundation documents among the participants or shareholders.²⁷⁶ The statutorily required foundation document is a charter of the entity which must be ratified by the

²⁶⁸ *Id.* art. 5.

²⁶⁹ *Id.* arts. 8–10.

²⁷⁰ *Id.* art. 5. Until the U.S.S.R. Fundamentals of Civil Legislation remain in force in Russia, however, *ultra vires* transactions still will be deemed invalid.

²⁷¹ Russian Enterprise Law, *supra* note 240, arts. 11–12.

²⁷² Russian Company Law, *supra* note 252, arts. 8–10.

²⁷³ *See generally id.*

²⁷⁴ *Id.* art. 7.

²⁷⁵ *Id.*

²⁷⁶ *Id.* arts. 11, 13, 14, 22. These foundation documents are filed with the local authority together with the application for registration and supporting documents executed by the founding shareholders. *See id.* arts. 15–17.

founding shareholders.²⁷⁷ The charter may be ratified by a resolution or memorandum of the founding shareholders or participants authorizing the creation of the company and other organizational matters.²⁷⁸ Under the former Soviet Joint Venture Law, a joint enterprise agreement in addition to a charter was also mandatory.²⁷⁹ This agreement was analogous to the western joint venture agreement or a shareholders' agreement.²⁸⁰ Such a joint venture or shareholders' agreement is optional for Russian stock associations²⁸¹ and may be executed essentially for the same reason as is given in the United States—protection of shareholders' rights.

Enterprises with foreign investment and foreign shareholders are also subject to a number of special requirements under the Russian Foreign Investment Law. The Russian Foreign Investment Law prescribes certain minimum requirements for the content of foundation documents of Russian stock companies.²⁸² The following provisions must be included: (1) the purposes and business objectives of the enterprise; (2) a list of participants; (3) the amount and procedures for the creation of the charter fund; (4) the percentage of each shareholder's or participant's share ownership; (5) the structure, composition, and authority (competence) of the management bodies; (6) the procedures for decision-making; (7) a list of issues requiring unanimous approval; and (8) procedures for liquidation.²⁸³ The Russian Company Law adds the requirement of listing the categories of issued stock and their nominal (par) values.²⁸⁴

c. Registration of Stock Companies

The Russian Company Law provides a number of registration rules for stock associations formed under Russian law.²⁸⁵ Russian

²⁷⁷ *Id.* art. 19.

²⁷⁸ *Id.* art. 25.

²⁷⁹ See *East-West Joint Ventures*, *supra* note 238, at 442. Notably, the Russian Company Law did not require the submission of a feasibility study to register a stock association with or without foreign investment.

²⁸⁰ *Id.*

²⁸¹ See Russian Company Law, *supra* note 252, art. 14.

²⁸² See Russian Foreign Investment Law, *supra* note 158, arts. 13–16.

²⁸³ See *id.* art. 13.

²⁸⁴ See Russian Company Law, *supra* note 252, art. 20.

²⁸⁵ Under the Soviet Company Law, a joint-stock association or a limited liability company also became a separate legal entity upon its registration. Registration was accomplished by filing an application form, minutes and resolution of the founding assembly, and notarized copies of the charter or articles of association with the executive committee of the local Soviet of People's Deputies (the "local authority") in the district or region where the company was

stock associations originally were required to register with the R.S.F.S.R. Ministry of Finance. Later, this requirement was conformed to the R.S.F.S.R. Law on Enterprises and Soviet Company Law. Registration on the local level is now required in the Russian Republic,²⁸⁶ with a subsequent informational filing with the R.S.F.S.R. Ministry of Finance.²⁸⁷ The R.S.F.S.R. Ministry of Finance maintains the centralized roster of all Russian companies, with or without foreign capital participation.²⁸⁸ Joint stock banking and insurance companies and other credit and financial institutions must register with the R.S.F.S.R. Central Bank.²⁸⁹ In addition, certain municipalities, such as the City of Moscow, now require that all companies register with their municipal agencies and impose their own registration and franchise tax requirements.²⁹⁰

Prior to registration, a Russian company must hold its founders' meeting, which must be attended by all of the founding shareholders of the company.²⁹¹ The primary purpose of this meeting is to approve the charter of the company and to elect the company's management by a three-fourths majority vote.²⁹² All other decisions at that meeting, including the decision to form a stock association, must be adopted unanimously.²⁹³ The application for registration must be prepared by the founding shareholders in accordance with the law and submitted to the local authority within thirty days after the founders' meeting.²⁹⁴ The application must identify the Company's name, address, business objective, principal activities, the size of its charter capital and the shareholders' obligations to capitalize it, the founders' names, addresses, citizenship, and the numbers of

to be located. The Soviet Company Law provided that registration must be made within thirty days of receipt of the application and that registration cannot be denied on the grounds that a company may not be commercially viable. The state register of companies contained the list of duly registered Soviet companies and information on their corporate purposes, activities, initial founders or shareholders, amount of the authorized charter fund, and principal place of business. See Soviet Company Law, *supra* note 154, arts. 7-12.

²⁸⁶ See Russian Enterprise Law, *supra* note 240, art. 34; Russian Company Law, *supra* note 252, art. 25; see also Patterson, *Putting the Laws into Practice*, 2 COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. (Mar. 1991) (source on file with the authors).

²⁸⁷ Russian Company Law, *supra* note 252, art. 29.

²⁸⁸ *Id.*

²⁸⁹ *Id.* art. 30.

²⁹⁰ See Moscow City Council Regulations on the Registration Procedure of Enterprises in the City of Moscow, July 29, 1991 (source on file with the authors).

²⁹¹ Russian Company Law, *supra* note 252, art. 22.

²⁹² *Id.* art. 24.

²⁹³ *Id.* art. 22.

²⁹⁴ *Id.* art. 15.

shares of stock they hold.²⁹⁵ The application must be signed by all of the founding shareholders and notarized.²⁹⁶ Once completed, the application is deemed a formal contract among the founding shareholders.²⁹⁷ The local authority must notify the founders as to the availability of the company name for registration within ten days of the application date.²⁹⁸ No business activity may be conducted prior to the completion of official registration.²⁹⁹

Registration requires the submission of the application for registration, the charter, and the minutes of the founders' meeting to the local authority.³⁰⁰ Review must be completed by the local authority within thirty days after the submission of these documents, and registration may be denied only for reasons of non-compliance with the Russian Company Law.³⁰¹ If registration is denied, it may be immediately appealed to a Russian court of law.³⁰² A temporary registration certificate is issued upon approval of the registration. If the company submits a confirmation of its payment of 50 percent of its charter capital within thirty days of the submission of documents, the local authority will issue an official certificate replacing the temporary registration certificate.³⁰³ All changes in the company's charter must be filed with the registering authority within fifteen days after such changes are adopted.³⁰⁴ Upon registration, a Russian company acquires the legal rights to own various types of property, to enter into contracts, to incur obligations, and to sue and be sued.³⁰⁵ One company may be a shareholder in another company, and conversely, may own subsidiaries and representative offices in the Russian Republic and abroad.³⁰⁶

The formation of joint venture companies or enterprises with foreign investment requires special governmental approvals prescribed by the Russian Foreign Investment Law.³⁰⁷ Most importantly,

²⁹⁵ *Id.* art. 16.

²⁹⁶ *Id.* art. 17.

²⁹⁷ *Id.*

²⁹⁸ *Id.* art. 18.

²⁹⁹ *Id.* art. 18.

³⁰⁰ *Id.* art. 25.

³⁰¹ *Id.* art. 32.

³⁰² *Id.*

³⁰³ *Id.* art. 33.

³⁰⁴ *Id.* art. 34.

³⁰⁵ *Id.* art. 4.

³⁰⁶ *See id.* art. 6.

³⁰⁷ *See, e.g.,* Russian Foreign Investment Law, *supra* note 158, arts. 14, 16. The requirements mandated by the Russian Foreign Investment Law are generally in addition to the standard registration procedures applicable to Russian enterprises without foreign capital.

an enterprise with foreign investment must also register with the R.S.F.S.R. Ministry of Finance.³⁰⁸ The registration requirements under the old Soviet Joint Venture Law no longer apply to new joint venture companies formed under Russian law.³⁰⁹

Registration with the Russian Ministry of Finance is the principal registration requirement for all foreign investment vehicles.³¹⁰ Certain organizations and companies, however, may require additional approvals. For instance, large construction or renovation projects require a state-conducted expert evaluation.³¹¹ Furthermore, some enterprises require ecological and sanitary/epidemiological approvals.³¹²

As mentioned, all enterprises with foreign investment are required to undergo "state registration."³¹³ In addition, any amendments to the original documentation must also be registered.³¹⁴ All newly formed Russian entities with foreign ownership require registration with the R.S.F.S.R. Ministry of Finance or any other duly authorized state body or agency.³¹⁵ Enterprises which receive more than one hundred million rubles in foreign investment must register with the Ministry of Finance.³¹⁶ The R.S.F.S.R. Council of Ministers must consent to this type of registration within two months of the application date.³¹⁷ The decision to register or reject registration must be given by the branch of the R.S.F.S.R. Ministry of Finance in the locality of the enterprise within twenty-one days from the appli-

³⁰⁸ See *id.* art. 16; Russian Company Law, *supra* note 252, art. 31.

³⁰⁹ The Soviet Joint Venture Law has lost the legal effect in the Russian Federation, see *infra* note 351; see also *Union Laws In Effect Unless Republics Have Own Statutes*, *Soviet Official Says*, E. Eur. Rep. (BNA) No. 3, at 106 (Nov. 25, 1991), available in LEXIS, BNA Library, EERPT File.

³¹⁰ See *infra* note 317 and accompanying text.

³¹¹ Russian Foreign Investment Law, *supra* note 158, art. 31.

³¹² *Id.* art. 14.

³¹³ *Id.* art. 16.

³¹⁴ *Id.* art. 34.

³¹⁵ *Id.* art. 16.

³¹⁶ *Id.*

³¹⁷ In order to register, the following documentation is required to be submitted for joint venture companies:

- a) founders' registration application;
- b) duly notarized foundation documents;
- c) conclusions of an expert evaluation (if required);
- d) for Russian participants, certain documents certifying their status and the right to contribute property;
- e) certificate of good credit standing for the Western participants; and
- f) proof of the foreign entities' status in accordance with its domestic law.

Id.

cation date.³¹⁸ Any registration rejection must be based either on non-compliance with Russian law or on an absence of required documentation.³¹⁹ The founders of the proposed company must be notified of the reasons for the rejection of its application,³²⁰ and a rejection may be appealed to a court of law.³²¹

Once registered, an enterprise with foreign investment receives a certificate of registration and acquires the status of a legal entity.³²² Local authorities receive the registration information, and a notice of registration is published in the Russian press.³²³

d. *Capital Contributions, Assets, and Securities*

Contributions into the share capital, or the statutory charter fund, of a stock company may be valued by the company's founders on the basis of world market prices or by contract.³²⁴ Foreign investors may make cash contributions in either rubles or in foreign currencies.³²⁵ Previously, under the Russian Foreign Investment Law and former Soviet law, all contributions made or expressed in foreign currencies had to use the Gosbank's exchange rate applicable to foreign trade operations.³²⁶ Now that the Gosbank exchange rate structure is abolished, a fluctuating, market-based exchange rate quoted by the Central Bank of Russia is in force.³²⁷

Under Russian Company Law, one founding shareholder is sufficient to form a stock association.³²⁸ The minimum capitalization

³¹⁸ *Id.* art. 17.

³¹⁹ *Id.* art. 18.

³²⁰ *Id.*

³²¹ *Id.*

³²² *Id.* art. 17.

³²³ *Id.* art. 17.

³²⁴ Russian Company Law, *supra* note 252, art. 37.

³²⁵ *Id.*

³²⁶ Russian Foreign Investment Law, *supra* note 158, art. 15. At that time, the official exchange rate of the Soviet ruble as fixed by the U.S.S.R. State Bank was about 1R = \$1.70.

³²⁷ See *infra* notes 452-453 and accompanying text.

³²⁸ Russian Company Law, *supra* note 252, art. 13. Under Soviet Company Law, there had to be at least two founders of a joint-stock association, whose holdings comprise at least 25 percent of the shares for the minimum period of two years. See Soviet Company Law, *supra* note 154, arts. 3, 41. Additionally, there was a minimum capitalization requirement, which provided that the nominal aggregate value of subscribed shares must be at least R500,000 for joint-stock associations (Article 30) and R50,000 for limited liability companies (Article 66). All subscribed shares of stock must be fully paid in before they are issued to shareholders. See *id.* art. 45. Payment for a share subscription may be made in any currency or through in-kind capital contributions, but the par value of share certificates must be stated in Rubles. See *id.* art. 16. Joint-stock associations' shares must have a minimum nominal value of R100 each, and may be issued only after payment. See *id.* art. 31.

requirements are as follows: R100,000 for an open stock association and R10,000 for a closed stock association.³²⁹ Fifty percent of the stock price must be paid by the founding shareholders within thirty days of registration; the balance of the stock price must be paid within one year from the date of registration.³³⁰ The minimum par value for one common share is R10.³³¹

Under Russian law, certificates of shares are securities (*tzennye bumagi*).³³² Russian pronouncements on securities set forth the formal requirements for registration and transfer of securities in the initial private or public offering and in the secondary markets.³³³ Under former Soviet law, shares could be issued either in bearer form or in drawer form (registered),³³⁴ although individuals were allowed to hold only the registered drawer shares.³³⁵ By contrast, the Russian Company Law provides for registered stock only.³³⁶

A Russian stock association may issue both common and preferred shares.³³⁷ Preferred shares (*priveligirovannnye aktzii*)³³⁸ normally carry no voting rights unless the company charter makes them voting stock.³³⁹ Preferences may exist for the distribution of divi-

³²⁹ Russian Company Law, *supra* note 252, art. 36.

³³⁰ *Id.* art. 38.

³³¹ *See id.* art. 44.

³³² *See* Regulations on the Issuance and Distribution of Securities and Stock Exchanges in the R.S.F.S.R., approved by the Resolution of the Russian Government No. 78, Dec. 28, 1991, translated in THE COMMERCIAL CODE OF RUSSIA: AN ADAPTIVE TRANSLATION OF THE LAWS OF THE RUSSIAN FEDERATION RELATING TO DOMESTIC AND FOREIGN COMMERCE 600-1-600-14 (Nallie V. Romanovskaya & Robert G. Allen eds., 1992) [hereinafter Securities Regulations]; Instruction No. 2 of the R.S.F.S.R. Ministry of Finance on the Rules Governing the Issuance and Registration of Securities in the Territory of the Russian Federation, Mar. 3, 1992 [hereinafter Finance Ministry Instruction].

³³³ Compare Securities Regulations, *supra* note 332, arts 5-10 and Ministry of Finance Instruction No. 2, *supra* note 332, with Soviet Company Law, *supra* note 154, arts. 31-33.

³³⁴ *See* U.S.S.R. Regulations on Securities, approved by the U.S.S.R. Council of Ministers Resolution No. 590, June 19, 1990, art. 5.

³³⁵ *See* Soviet Company Law, *supra* note 154, art. 34.

³³⁶ Russian Company Law, *supra* note 252, art. 46. "[S]hareholders shall be listed in a special stock register maintained by the company." *Id.*

³³⁷ *Id.* art. 47. Soviet limited liability companies did not issue stock. Instead, they had a charter fund divided into equity shares which were not represented by certificates of stock. Such shares were not deemed securities or negotiable instruments. At registration, not less than 30 percent of the authorized charter fund had to be paid in by every participant. The remainder had to be paid in within one year following registration of the company. Transfer or sale of shares was possible only after they were fully paid in and all restrictions on transferability were satisfied. The transferee acquired all rights and obligations of the transferor. The company could reserve the right of first refusal. *See* Frenkel, *supra* note 257, at 155.

³³⁸ Under Soviet Company Law, the preferred stock could not be issued for an amount exceeding 10 percent of the authorized share capital. *See* Soviet Company Law, *supra* note 154, art. 35.

³³⁹ Russian Company Law, *supra* note 252, art. 49.

dends or the distribution of the company's assets upon its liquidation.³⁴⁰

Under the Russian Company Law, shares are freely transferable and their sale or transfer does not require the company's approval, unless the company charter states otherwise.³⁴¹ The ownership of shares is recorded on the company's stock ledger.³⁴² The Russian Company Law also authorizes a stock association to issue debt securities (*obligatziyi*)³⁴³ in either bearer or registered form³⁴⁴ to either legal entities or individuals.³⁴⁵ Bonds are freely transferable.³⁴⁶

In addition to the statutory charter fund, a company must also establish a reserve fund.³⁴⁷ Annual transfers are to be made to the reserve fund until the fund reaches at least 10 percent of the share capital.³⁴⁸ The company's charter may require a higher percentage.³⁴⁹ The charter may also regulate the size and frequency of the annual transfers as well as the proportion of share capital.³⁵⁰

e. *Organization and Governance*

The management structure of an enterprise with foreign investment depends on its organization as a legal entity. The governance of stock associations is facilitated by a time-proven management structure, traditional in U.S. corporation law and embodied in the

³⁴⁰ *Id.*

³⁴¹ *Id.* art. 7.

³⁴² "Transfer of the certificate from one person to another constitutes the completion of the transaction and the transfer of rights of ownership to the stock only if the operation is recorded in accordance with established procedure." *Id.* art. 57.

³⁴³ *Id.* art. 59. The Soviet Company Law also authorizes a joint-stock association to issue debt securities (*obligatziyi*) in either bearer or registered form to either legal entities or individuals. Such bonds may only be issued in an amount not exceeding 25 percent of the company's authorized share capital and only after full payment for all issued shares has been received. Bonds are freely transferrable. See Frenkel, *supra* note 257, at 155.

³⁴⁴ Under Soviet Company Law, such bonds could only be issued in an amount not exceeding 25 percent of the company's authorized share capital and only after full payment for all issued shares has been received. See Soviet Company Law, *supra* note 154, art. 36.

³⁴⁵ Russian Company Law, *supra* note 252, art. 61.

³⁴⁶ *Id.*

³⁴⁷ *Id.* art. 81.

³⁴⁸ *Id.*

³⁴⁹ *Id.* art. 81.

³⁵⁰ *Id.* Under the Soviet Company law, annual transfers were to be made to the reserve fund until it reached at least 15 percent of the share capital. See Soviet Company Law, *supra* note 154, art. 19. The company's charter may determine a higher percentage and also the size of the annual transfers (as well as the proportion of share capital), but the annual transfers may not be less than 5 percent of the company's annual profits. See *id.*

Russian Company Law. Other entities are governed in accordance with the charter or other foundation document chosen by the participants unless a statutorily mandated management structure exists. The Soviet Joint Venture Law originally restricted the nationality of individuals managing foreign investment enterprises. This law is no longer in effect, and thus, members of the Board of Directors and the General Manager or President of a joint venture company may now be foreign nationals.³⁵¹

The general assembly of shareholders (General Assembly) constitutes the supreme governing body of a Russian stock association.³⁵² The chair of the General Assembly must also serve as the chair of the Board of Directors.³⁵³ Annual meetings of the General Assembly must take place not more than fifteen months apart.³⁵⁴ Special meetings may be called by the Board of Directors, the Audit Commission, or at least 10 percent of the shareholders.³⁵⁵ At the meetings of the General Assembly, shareholders elect members of the Board of Directors and approve the company's annual reports.³⁵⁶ Also within the exclusive competence of the General Assembly are charter amendments, charter fund decreases or increases, creation and liquidation of subsidiaries and branches of the company, and liquidation of the company.³⁵⁷

Between the meetings of its General Assembly of Shareholders, the Board of Directors (Board) is the supreme governing body of a

³⁵¹ The former Soviet Joint Venture Law required in article 21 that the chairman of the board be a Soviet citizen. The Joint Venture Decree, art. 21, SP SSSR, Jan. 13, 1987, No. 9, Item 40, *translated in* KAJ HOBER, JOINT VENTURES IN THE SOVIET UNION app. 3 (1992) [hereinafter Soviet Joint Venture Law]. Again, the references to Soviet law may be useful because some republics other than the Russian republic have adopted the all-Union version of company law with little change.

³⁵² Article 91 of the Russian Company Law provides:

The supreme governing body of the *tovarishchestvo* [stock association] is the general stockholders' meeting, which has exclusive jurisdiction over changes in the charter and the charter capital, election of directors, approval of annual operating results, creation and liquidation of daughter companies [subsidiaries] or branches, and reorganization and liquidation of the [company].

Russian Company Law, *supra* note 252, art. 91. For a comparison to the U.S. corporate governance model, see generally Melvin A. Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CAL. L. REV. 1 (1969).

³⁵³ Russian Company Law, *supra* note 252, art. 100.

³⁵⁴ *Id.* art. 92.

³⁵⁵ *Id.* arts. 93-94.

³⁵⁶ *Id.* art. 98.

³⁵⁷ *Id.* art. 91.

stock association.³⁵⁸ It exercises general governance powers of a corporate board of directors except for those powers granted exclusively to the shareholders.³⁵⁹ The members of the Board are elected for two-year terms,³⁶⁰ and the Board must convene for regular meetings at least once every month.³⁶¹ The General Assembly appoints a General Manager, or President, of the stock association from among the members of the Board.³⁶² The Board, in turn, appoints other management officers to implement its policies and decisions.³⁶³

f. *Control*

Western investors now can achieve control of Russian stock associations in the same way as with U.S. corporations. Investors can gain control directly through beneficial ownership of stock, and indirectly by electing members of the Board.³⁶⁴ This is a major advancement over the previous non-stock approach of Soviet joint enterprises, which could not accommodate institutional investors or other passive investors not interested in active management of the joint enterprise.³⁶⁵ The flexibility of transferring control through a stock purchase also has many benefits over the archaic Soviet system of transferring generic ownership rights or "joint enterprise interests" in the joint enterprise to a third party.³⁶⁶

g. *Termination*

Under Russian Company Law,³⁶⁷ termination of the stock association's legal existence may be affected either by reorganization—in

³⁵⁸ *Id.* art. 108.

³⁵⁹ *Id.* art. 116.

³⁶⁰ *Id.* art. 111.

³⁶¹ *Id.* art. 121.

³⁶² *Id.* art. 124.

³⁶³ *Id.* arts. 125–26.

³⁶⁴ See Frenkel, *supra* note 263, at 152–53.

³⁶⁵ See Arthur L. George & Thomas A. O'Donnell, *The Russian Republic Joint-Stock Decree*, E. Eur. Rep. (BNA) 46–47 (June 5, 1991), available in LEXIS, BNA Library, EERPT File; Dobkin & Burt, *Soviet Joint Venture Legislation and Regulations, and Recent Related Legal Developments*, The Soviet Union and Eastern Europe: Recent Developments in Trade, Investment and Finance at 41 (ABA Seminar) (Oct. 13–14, 1988) (source on file with the authors).

³⁶⁶ See Mark S. Vecchio, *Soviet Joint Ventures: Keeping an Eye on the Goalposts*, INT'L FIN. L. Rev., Apr. 1990, at 37–38.

³⁶⁷ Under Soviet Company law, stock associations could terminate their legal existence after dissolution and liquidation or following reorganization by means of mergers, acquisitions, consolidation, etc. See Soviet Company Law, *supra* note 154, art. 25. Liquidation was conducted by a liquidation commission formed by the company or, in the event of judicial (involuntary)

the form of a merger, spin-off, or consolidation—or by liquidation.³⁶⁸ Under the Russian Foreign Investment Law, an enterprise with foreign investment must be liquidated in accordance with procedures provided by Russian law for that entity's organizational form.³⁶⁹ In the case of voluntary liquidation, the general assembly appoints a liquidation commission to wind down the business and present a liquidation balance sheet to the general assembly for its approval.³⁷⁰ Any assets remaining after salaries, taxes, and payments to creditors will be distributed among the shareholders generally in proportion to their shareholdings, or as otherwise stipulated in the charter.³⁷¹ A corporate reorganization effects a transfer of the reorganized company's rights and liabilities to its legal successors.³⁷²

4. Operations and Regulatory Regime

a. *Economic and Administrative Decentralization Trends and Effects*

In the transitional period from a command economy to full economic independence and market relations, President of the Russian Republic Boris Yeltsin has issued a number of interim decrees directly affecting foreign businesses operating in Russia. In the wake of the break-up of the Soviet Union as a political entity and general annulment of the Soviet federal private civil law, these decrees are extremely important. The interim decrees, as well as recent laws and regulations of various republics formerly constituting the U.S.S.R. become extremely important and must be analyzed against the skeletal framework of the Russian Foreign Investment Law. The

liquidation, by the competent court or arbitrator. *Id.* art. 26. The liquidation commission wound up the affairs of the company, paid off remaining liabilities, and distributed the company's remaining assets to its shareholders. Liquidation took legal effect upon the appropriate entry in the register of companies. *Id.*

A stock company could be dissolved once it had accomplished its purpose, when a stipulated period of time had elapsed, by a decision of the shareholders' meeting, or for other reasons enumerated in its charter. *Id.* art. 24. Article 24 of the Soviet Company Law also stipulated that a joint stock company may be dissolved "on the basis of a decision of State Arbitrazh or a court in the event of the insolvency of the society. . . ." *Id.* The language seems broad enough to include bankruptcy as a ground of dissolving a joint stock company. Currently, however, there is no bankruptcy legislation applicable to private enterprises on the books in the Russian Federation.

³⁶⁸ See Russian Company Law, *supra* note 252, art. 142.

³⁶⁹ See Russian Foreign Investment law, *supra* note 158, art. 19.

³⁷⁰ Russian Company Law, *supra* note 252, arts. 136–38.

³⁷¹ *Id.* arts. 138–39.

³⁷² *Id.* art. 144.

decrees also display Mr. Yeltsin's determination to carry through with the economic reforms in order to create a market economy in Russia. The principal decree, entitled *On Liberalizing Foreign Economic Activity on the Territory of the R.S.F.S.R.* of November 15, 1991 (Decree on Liberalization),³⁷³ purports to relax some of the more stringent restrictions on foreign trade and investment in Russia and effectively eliminates the all-Union (central) legal regime and regulation within its borders.³⁷⁴ The decree went into effect on January 1, 1992.³⁷⁵

The regulatory structure affecting business operations in the Russian territory has been changed significantly. Since the demise of the central Soviet authorities in late 1991, all of the all-Union institutions have either been disbanded or absorbed into the Russian republican government structure, and the all-Union laws have been declared null and void in the territory of the Russian Republic and other republics formerly constituting the Union.³⁷⁶ For instance, in the Russian Republic, the powerful U.S.S.R. Ministry for External Economic Relations and the U.S.S.R. Ministry of Finance have been abolished, and their functions have been transferred to the Russian Ministry of Foreign Trade and Russian Ministry of Finance respectively.³⁷⁷ Other republics are in the process of establishing their own republican ministries responsible for foreign trade and investment. The ministries also serve as independent regulators in their respective territories.³⁷⁸

Despite potential long-term benefits inherent in both the liberation of former Soviet republics from the communist yoke and regulatory and economic decentralization, many short-term effects on trade and commerce within Russia have been disruptive and have resulted in chaos. The sudden withdrawal of the state from eco-

³⁷³ For the unofficial translation of the text of the Decree on Foreign Economic Activity in Russia, see 1 E. Eur. Rep. (BNA) No. 3, at 145 (Nov. 25, 1991), *available in* LEXIS, BNA Library, EERPT File; *see also* *Yeltsin Decrees Assert Russian Control Over Foreign Transactions, Resources*, 1 E. Eur. Rep. (BNA) No. 3, at 104-05 (Nov. 25, 1991), *available in* LEXIS, BNA Library, EERPT File.

³⁷⁴ *See Russia Intends to Reduce Regulatory Restraints on Trade*, 9 Int'l Trade Rep. (BNA) 357 (Feb. 26, 1992), *available in* LEXIS, BNA Library, Intrad File.

³⁷⁵ *Id.*

³⁷⁶ *See Yeltsin Solidifies Control Over Key Soviet Ministries*, E. Eur. Rep. (BNA) No. 1, at 4, 6 (Jan. 6, 1992), *available in* LEXIS, BNA Library, EERPT File [hereinafter *Yeltsin Solidifies Control*]; *After the Coup: Political Upheaval Forces Reassessment of Legal Issues*, 2 SOVIET BUS. L. REP., No. 5, Sept. 20, 1991, *available in* LEXIS, Nexis File, RCBLR.

³⁷⁷ *Yeltsin Solidifies Control*, *supra* note 376, at 6.

³⁷⁸ *See Collapse of Union, Rise of Republics Forcing Change in U.S. Business Plans*, E. Eur. Rep. (BNA) No. 3, at 136-39 (Nov. 25, 1991), *available in* LEXIS, BNA Library, EERPT File.

conomic planning functions paralyzed some old distribution and supply networks on which state enterprises traditionally relied.³⁷⁹ Market forces, widely expected to alleviate disastrous effects of this collapse in the state administrative control over trade, have so far been unsuccessful in replacing the old system.³⁸⁰ With the absence of both rational markets for goods and commodities and an established infrastructure for the Russian market economy, achieving a high degree of operational self-sufficiency remains one of the principal problems. Management of these deficiencies is also the key to a successful investment strategy for the enterprise with foreign investment looking for local distributors, agents and franchisees, and suppliers.³⁸¹

The deregulation of prices for most consumer and industrial goods which began in January 1992 laid the foundation for a free market.³⁸² These goods, with the exception of some essential food items and medicine, are no longer subject to any government price controls and will be set freely by their producers.³⁸³ The social security net to assist the Russians with adapting to market pricing and to provide minimum subsistence guarantees is not in place yet, thereby causing serious social problems.³⁸⁴ Although not commensurate with price increases, the eventual rise in government salaries and pensions should help the population deal with the price increases and the resulting hyperinflation. Some of the price increases were in the 1000 percent range.³⁸⁵

The legal framework for the economic relations between the former Soviet republics, now members of the Commonwealth of Independent States, is just beginning to evolve through treaties and intergovernmental agreements. It is clear, however, that no central authority will be created to impose its decisions on the member republics as the old Union did through institutions such as the U.S.S.R. Council of Ministers and the U.S.S.R. Supreme Soviet.³⁸⁶

³⁷⁹ See Ericson, *Economics*, in *AFTER THE SOVIET UNION: FROM EMPIRE TO NATIONS* 64-70 (Levgold & Colton eds., 1992) (source on file with the authors).

³⁸⁰ See Stephan, *Perestroika and Property: The Law of Ownership in the Post-Socialist Soviet Union*, 39 AM. J. COMP. L. 35, 61 (1991); Ericson, *supra* note 379, at 64-70.

³⁸¹ See Jeffrey M. Hertzfeld, *Joint Ventures: Saving the Soviets from Perestroika*, HARV. BUS. REV. 80, 81 (Jan-Feb. 1991).

³⁸² See *Prices Freed Despite Concerns Over Impact on Economy, Neighbors*, E. Eur. Rep. (BNA) No. 2, at 40 (Jan. 20, 1992), available in LEXIS, BNA Library, EERPT File.

³⁸³ *Id.*

³⁸⁴ See Ericson, *supra* note 379, at 64.

³⁸⁵ See *id.* at 78.

³⁸⁶ See *U.S. Welcomes Declaration Announcing Union of Russia, Ukraine, Byelorussia*, E. Eur. Rep. (BNA) No. 5, at 206-07 (Dec. 23, 1991), available in LEXIS, BNA Library, EERPT File.

Most bureaucrats employed by these central authorities will not find new positions open to them in the republican Russian government and, consequently, western business interests in Russia will have to develop new ties with the Russian republican lawmakers and regulators for their lobbying activities.³⁸⁷

While the Russian law, which began to gain prominence in 1990, is by far the most comprehensive of all former Soviet republics, it is not yet sufficient to govern private commercial activity in the conditions of a free market.³⁸⁸ To that end, President Yeltsin signed several dozen new laws and decrees throughout 1992.³⁸⁹ Moreover, foreign investors in Russia can also rely on such earlier Russian legislative enactments essential to the foreign investor as Law on Foreign Investment Activities³⁹⁰, Law on Enterprise,³⁹¹ Regulations on Stock Associations,³⁹² Law on Property,³⁹³ and Law on Privatization³⁹⁴, which have become the backbone of the Russian foreign investment regime in structuring their investments. Other republics of the former Union, however, need much greater legislative reform. Soviet jurisprudence, although influential to the new republican laws, is bound to wither away in a matter of years once the transitional period for the republican legal structure is over and the C.I.S. republics' legal systems become firmly entrenched in the principles of free market economics and open societies.

b. *Status in the Russian Economy*

Generally, an enterprise with foreign investment may conduct any business activity in accordance with the "business purposes" enumer-

³⁸⁷ This is true of most top-level ministerial and departmental positions, which have been subject to change in Russia even after the break-up of the Soviet Union due to political undercurrents. Middle- and low-level government and administrative positions in the Russian Federation and other C.I.S. republics are probably still occupied by the same officials as under the Soviet regime.

³⁸⁸ See generally Cole Corette & Abrutyn, *Legal and Practical Aspects of Doing Business in the Soviet Republics*, in LEGAL AND PRACTICAL ASPECTS OF DOING BUSINESS IN THE SOVIET REPUBLICS, at 69 (PLI Handbook Series No. 604, 1992) (source on file with the authors).

³⁸⁹ See, e.g., *infra* notes 422-423.

³⁹⁰ See Russian Foreign Investment Law, *supra* note 158; see also Law on Investment Activity in the R.S.F.S.R., S.P. R.S.F.S.R., June 26, 1991, translated in W.E. BUTLER, BASIC DOCUMENTS OF THE RUSSIAN FEDERATION 251 (1992).

³⁹¹ Russian Enterprise Law, *supra* note 240.

³⁹² Russian Company Law, *supra* note 252.

³⁹³ Russian Property Law, *supra* note 239.

³⁹⁴ Law on Privatization of State and Municipal Enterprises, July 3, 1991, translated in HOBER, *supra* note 1, at app. 51 [hereinafter Russian Privatization Law].

ated in its charter, except as prohibited by Russian law.³⁹⁵ For example, all banking, insurance, and securities brokerage activities require licensing by the Russian Central Bank or other regulatory bodies.³⁹⁶ The R.S.F.S.R. Council of Ministers may determine additional activities of enterprises with foreign investment that may be subject to licensing.³⁹⁷ The Russian Company Law also lists certain business activities in which stock associations, with or without foreign investment, may not engage altogether.³⁹⁸ Thus, for all practical purposes, an enterprise with foreign investment or a joint venture company engaging in most industrial, trade, and service activities, is not treated differently from a domestic company with regard to its legal status in doing business in Russia.

c. *Supplies*

Joint ventures with foreign partners and other foreign-owned ventures no longer enjoy any special benefits with respect to the provision and sourcing of supplies from state ministries and enterprises.³⁹⁹ All supplies must be contractually procured from domestic

³⁹⁵ Russian Foreign Investment Law, *supra* note 158, art. 20. This provision essentially allows the Russian government to enact protectionist legislation favoring its domestic industry at the expense of foreign investors. Bilateral investment treaties, however, typically impose limits on such restrictions, and the law recognizes all international obligations of the Russian Federation with respect to the protection of foreign investors' rights. *See id.* art. 6; *infra* note 557. For instance, the U.S.-Russia Investment Treaty provides that the Russian government may impose restrictions on foreign investment only in certain specified industries and only to a certain extent. *See* U.S.-Russia Investment Treaty, RUSSIA & COMMONWEALTH BUS. L. REP., Aug. 10, 1992, art. 2, *available in* LEXIS, Nexis Library, RCBLR File.

³⁹⁶ *See* Russian Foreign Investment Law, *supra* note 158, art. 20. For provisions of licensing and registration of commercial banks in the Russian Federation, *see* Banks and Banking Business in the R.S.F.S.R. Act 1990, Vedomosti R.S.F.S.R., arts. 11-18, Dec. 2, 1990, No. 395-I, *translated in* Banks and Banking Business in the R.S.F.S.R. Act 1990, Sov. Legislation, Dec. 2, 1990 (source on file with the authors) [hereinafter Russian Law on Banking].

³⁹⁷ Russian Foreign Investment Law, *supra* note 222, art. 20.

³⁹⁸ *See* Russian Company Law, *supra* note 252, art. 2. Article 2 of the Russian Company Law provides that activities of stock associations in the defense, mining of precious and rare metals, minerals, raw materials, forestry, and fur trade sectors may only be conducted with the permission of the R.S.F.S.R. Council of Ministers. *Id.*

³⁹⁹ In the past, integration of joint ventures with western partners into the Soviet economy and gaining access to supplies and raw materials largely depended upon access to the Soviet bureaucracy which wielded absolute control over the centrally controlled distribution system. *See* Surrey & Lechtman, *New Soviet Joint Venture Law: A Political Curiosity or a Real Investment Opportunity?*, PRIVATE INVESTORS ABROAD - PROBLEMS AND SOLUTIONS IN INTERNATIONAL BUSINESS IN 1988 6-1, 6-9 (1989) (source on file with the authors). Those joint ventures that were successful in obtaining special benefits granted on a case-by-case basis by the Soviet industrial ministries could improve their otherwise poor chances for regular and reliable supplies of raw materials and parts provided as part of the infamously inefficient central planning distribution system. *See* Felker, *supra* note 10, at 224.

or foreign sources, and the government plays little role in the allocation and distribution of raw materials, parts, and other supplies.⁴⁰⁰ Joint enterprises may resort to countertrade with the appropriate permissions from the relevant republican Ministry of Foreign Trade.⁴⁰¹ It must be emphasized, however, that in the new post-Soviet environment, the economic decentralization reforms have not yet achieved the objective of facilitating vertical integration of Russian industrial entities. Instead of easing the task of procuring essential materials for the manufacturing needs of enterprises with foreign investment, the reforms appear to have compounded it.⁴⁰² Consequently, dealing with the problem of misallocated resources, shortages of raw materials, and diversion of goods to black markets frequently requires foreign-owned Russian companies to look elsewhere for supplies—ordinarily having to purchase and import them into Russia from the West for convertible currency.

d. *Sales*

Domestic distribution in Russian markets of products and services of an enterprise with foreign investment may be accomplished on a contractual basis in Russian currency or, with certain restrictions, foreign currency.⁴⁰³ Essentially, all central planning and control features of the Russian Republic's economy are now abolished for most domestic and all joint venture companies and other enterprises with foreign investment.⁴⁰⁴ Thus, joint venture and wholly-owned foreign

⁴⁰⁰ For a discussion of central planning and allocation of supplies in the U.S.S.R., see H. STEPHEN GARDNER, *SOVIET FOREIGN TRADE: THE DECISION PROCESS* 1–15 (1983).

⁴⁰¹ While the Russian Federation abolished the requirement of licensing so-called "intermediary activity," certain barter and countertrade transactions in other C.I.S. republics are still subjected to licensing requirements.

⁴⁰² See Felker, *supra* note 10, at 224.

⁴⁰³ See Russian Foreign Investment Law, *supra* note 158, art. 22.

⁴⁰⁴ *Id.* art. 5; see also Decree on the Freedom of Trade, Feb. 1, 1992; Decree on Measures to Liberalize Prices, Dec. 6, 1991 (source on file with the authors); Decree on Measures to Liberalize Prices, Dec. 16, 1991 (source on file with the authors); see generally Stephan, *supra* note 380, at 48–59. Although as of 1991, 80 percent of production in the Soviet economy remained under central planning, due to the radical measures hastily implemented by the Russian government throughout 1992 to restructure domestic economic relations, central planning to a large extent ceased to be the pervasive feature of the state administrative control over economic matters. See Stephan, *supra* note 139, at 97. As privatization proceeds, gradually diminishing the state ownership and control over the industry, agriculture, and trade, and as state ministries relinquish administrative responsibility over those few state-owned enterprises remaining, foreign investors are unlikely to be affected significantly by the remnants of the central planning policies exercised by the state.

companies are free to sell their goods and services directly to the public or through Russian wholesalers and retailers.

The principal benefit of the economic decentralization for foreign investors is that the Russian enterprises they control or with whom they contract are no longer subject to general price controls. Until 1991, the Soviet central planning authorities utilized a comprehensive system of administrative regulations that fixed prices from production to retail levels.⁴⁰⁵ Even though enterprises with foreign investment had been free from price controls due to the express provision of the Russian Foreign Investment Law,⁴⁰⁶ and joint enterprises under the Soviet Joint Venture Law had been similarly exempted from Soviet price controls,⁴⁰⁷ administratively set prices tended to interfere with the conduct of business operations because they distorted market information and inhibited the formation of organized markets.⁴⁰⁸ The Russian government has removed most of the price controls and, for the most part, has allowed market forces to regulate the price formation for most industrial and consumer goods.⁴⁰⁹ State imposed prices for goods and services priced in rubles no longer apply to the products and services of private companies, including those produced by joint venture companies.

e. *Export-Import Operations*

Most enterprises with foreign investment have the same foreign trade rights and privileges as Russian enterprises. Under the Russian Foreign Investment law, wholly-owned subsidiaries of foreign companies and joint enterprises with more than 30 percent foreign ownership—15 percent under Soviet law— may export their own production without obtaining an export license.⁴¹⁰ These entities may also import goods for their own needs without foreign trade

⁴⁰⁵ See MARGIE LINDSAY, *INTERNATIONAL BUSINESS IN GORBACHEV'S SOVIET UNION* 102-03 (1989); ZWASS, *MONETARY COOPERATION BETWEEN EAST AND WEST* 4, 16 (1975). In 1991, Soviet law still imposed certain price controls on various goods considered vital to national economic recovery.

⁴⁰⁶ Russian Foreign Investment Law, *supra* note 158, art. 22.

⁴⁰⁷ See *generally* Soviet Joint Venture Law, *supra* note 351.

⁴⁰⁸ Felker, *supra* note 10, at 228.

⁴⁰⁹ The legal foundation for the movement to have pricing freed from government regulation in Russia, which resulted in many prices being decontrolled and many price subsidies eliminated, can be found in several of the first of Yeltsin's decrees following the independence of the Russian Federation. See Decree on Measures to Liberalize Prices, Dec. 6, 1991; Decree on Measures to Liberalize Prices, Dec. 1991.

⁴¹⁰ Russian Foreign Investment Law, *supra* note 158, art. 25.

licenses.⁴¹¹ Otherwise, an export or import license may be required, although the Russian legislation on foreign trade has reduced the list of goods and services subject to licenses and quotas.⁴¹²

Until 1992, the Soviet export/import licensing regime for foreign trade prevailed, requiring registration with the U.S.S.R. Ministry for Foreign Economic Relations and requiring licenses for certain goods, commodities, and services.⁴¹³ Although most Soviet entities were given the right to engage in foreign trade transactions, the export/import regime was complicated and cumbersome, requiring Soviet entities other than joint ventures with foreign participants to obtain special registration.⁴¹⁴ By late 1991, the Russian Ministry for Foreign Trade assumed the export/import licensing responsibility and generally liberalized the licensing regime.⁴¹⁵ In particular, foreign trade registration was no longer required for Russian enterprises engaging in export/import operations,⁴¹⁶ and no special permission was required for intermediary (brokerage) activities.⁴¹⁷

⁴¹¹ *Id.*

⁴¹² See Decree No. 90 on Licensing and Imposing Quotes for Exported and Imported Goods in the Territory of the Russian Federation, Dec. 31, 1991 (source on file with the authors); Decree on Introduction of Export Tariffs on Certain Goods Exported from the Territory of the Russian Federation, Dec. 31, 1991 (source on file with the authors); see generally Youry Petchenkine, *New Foreign Trade Procedures, Licenses and Quotas*, East/West Exec. Guide, Feb. 1992, at 25–27 (source on file with the authors).

⁴¹³ See Decree of the U.S.S.R. Council of Ministers for Regulation of Foreign Economic Activities, S.P. S.S.S.R., Mar. 7, 1989, Decree No. 203, *translated in* HOBBER, *supra* note 1, app. 22 [hereinafter Decree on Measures for Foreign Economic Activities]; see generally Stephan, *supra* note 139, at 90–91.

⁴¹⁴ See Decree of the U.S.S.R. Council of Ministers on the Further Development of Foreign Economic Activities of State, Cooperative and Other Public Enterprises, Associations, and Organizations, art. 2, 31 S.P. S.S.S.R., Dec. 2, 1988, *translated in* HOBBER, *supra* note 1, app. 5; Decree on Measures for Regulation of Foreign Economic Activities, *supra* note 413, art. 2; Regulations for Licensing of Foreign Economic Operations in the U.S.S.R. of March 20, 1989, 1989 Biulleten Normativnykh Aktov Ministerstv i Vedomstv SSSR No. 9, at 25, *translated in* *USSR Legal Materials* (source on file with the authors).

⁴¹⁵ See Decree of the President of the Russian Federation on the Liberalization of Foreign Trade Activity, Nov. 30, 1991, *translated in* HOBBER, *supra* note 1, at app. 57 [hereinafter Liberalization Decree]; Decree No. 90 on Licensing and Imposing Quotes for Exported and Imported Goods in the Territory of the Russian Federation, Dec. 31, 1991 (source on file with the authors); Decree on the Basic Principles for Effectuating Foreign Economic Activities on the Territory of the R.S.F.S.R., S.D. R.S.F.S.R., July 14, 1990, *translated in* W.E. BUTLER, *BASIC DOCUMENTS OF THE RUSSIAN FEDERATION* 249 (1991).

⁴¹⁶ Foreign trade registration was not required unless so-called “strategic” raw materials, technology, or equipment are being exported, in which case registration with the Ministry of External Economic Relations is necessary and a special licensing and quota system must be followed.

⁴¹⁷ See Liberalization Decree, *supra* note 415, art. 2; see also Mikhail Berger, *Freedom of Foreign Trade Will Come Together with Free Prices*, *RUSSIAN PRESS DIGEST*, Jan. 2, 1992, available in LEXIS, World Library, SPD File. Foreign trade licenses, formerly required of any entity

Russian laws now exclusively govern all foreign trade barter operations.⁴¹⁸ Export and import licenses are still required for certain products and commodities, but the Russian government has issued new lists of products and commodities which should be subject to more liberal licensing provisions, quotas, or prohibitions.⁴¹⁹ New Russian laws also eliminated foreign trade organizations, which had previously completely monopolized Soviet foreign trade by acting as official middlemen between producers and purchasers.⁴²⁰ In addition, the Russian government presently envisages a competitive or auctioned sale of export licenses.⁴²¹

With respect to certain raw materials and goods which have traditionally earned the Soviet Union highly needed foreign exchange, however, the licensing requirements applicable to exporting procedures have been strengthened with the view of retaining state monopoly over the foreign trade in energy and natural resources. Oil and oil products and derivatives, along with other fuels and exportable commodities, are subject to quotas and high export tariffs.⁴²² New controls for so-called "strategic" items have been introduced to monitor and regulate the export of defense-oriented items.⁴²³ Stra-

organized under Soviet law in order to conduct export/import operations, are no longer required.

⁴¹⁸ Liberalization Decree, *supra* note 415, art. 2.

⁴¹⁹ Such new lists of products subject to licenses and quotas have been issued and are continually being updated. See *Russian Export and Import Licensing Regulations*, BBC Summary of World Broadcasts and Monitoring Reports, Jan. 17, 1992, available in LEXIS, Nexis Library, BBCSWB File; *Russia Intends to Reduce Regulatory Restraints on Trade*, 9 Int'l Trade Rep. (BNA) No. 9, at 357 (1992), available in LEXIS, BNA Library, Intrad File.

⁴²⁰ See *Russia Eliminates Foreign Trade Organizations As Official Middlemen*, 9 Int'l Trade Rep. (BNA) No. 8, at 299 (Feb. 19, 1992), available in LEXIS, BNA Library, Intrad File.

⁴²¹ See Liberalization Decree, *supra* note 415, art. 2.

⁴²² See Presidential Decree on Procedures of Exporting Strategically Important Commodities No. 628 of June 14, 1992 (source on file with the authors); see also *Russia: "Strategic Materials" Export Requires Special Permit*, BUSINESS EASTERN EUROPE, Aug. 10, 1992, at 390, available in LEXIS, Europe Library, Bueeur File; *Russia's Oil Export Tariffs Hurt Prospects for Foreign Investment, Businessmen Claim*, 9 Int'l Trade Rep. (BNA) 447 (Mar. 11, 1992), available in LEXIS, BNA Library, Intrad File.

⁴²³ See Presidential Decree No. 388 on Measures to Create a System of Export Control in Russia, Apr. 11, 1992 (source on file with the authors); Decree of the Russian Government No. 469, July 5, 1992 (source on file with the authors). It should be noted that the lists of commodities under Decree No. 469 is quite long and includes many general categories of raw materials, natural resources, and products directly unrelated to defense production; export licenses for these items must be obtained from the Russian Commission on Export Control. These "dual-use" articles include pharmaceuticals, non-ferrous metals, and plastics. Export of defense-related materials is specifically addressed in the Presidential Decree No. 312 of March 27, 1992 on Control of the Export of Nuclear materials, Equipment and Technologies (source on file with the authors). See also Hartnett, *New Controls for Strategic Items*, East/West Exec. Guide, Oct. 1992, at 27 (source on file with the authors).

tegic items are not limited to military hardware and extend to many raw materials and energy products.⁴²⁴ Joint ventures and other enterprises with foreign investment proposing to engage in export transactions involving strategic commodities should apply to the Ministry of External Economic Relations which auctions off quotas and grants export licenses.⁴²⁵

Under Russian law, all property imported into Russia as a capital contribution to a charter fund is exempt from customs duties and import taxes. If the enterprise entails foreign investment and the contribution is to be used in the enterprise's manufacturing operations.⁴²⁶ Other items purchased from foreign suppliers and contractors can be imported into Russia subject to payment of applicable import duties implemented pursuant to the new Russian regulations.⁴²⁷ The Russian Customs Committee is drafting a comprehen-

⁴²⁴ Strategic raw materials include crude oil, petroleum products, natural gas, electricity, coal, timber and lumber, nonferrous metals, rolled iron and steel, mineral fertilizers, grain, furs, and inorganic acids. See Regulations of the Ministry of External Economic Relations on the Registration of Enterprises and Organizations Which Have the Right to Export Strategically Important Raw Materials of July 1992 (source on file with the authors); see also Youry Petchenkine, *Regulation of External Economic Activities*, East/West Exec. Guide, Nov. 1992, at 27-29 (source on file with the authors).

⁴²⁵ For the most recent overview of the export licensing process, see Guzel Anulova, *Russia: Export Licensing Procedures Revised*, BUSINESS EASTERN EUROPE, Dec. 14, 1992, at 607, available in LEXIS, Europe Library, Bueeur File.

⁴²⁶ Russian Foreign Investment Law, *supra* note 158, art. 24. Exemption from customs duties and import taxes is only effective, however, if the goods are imported into Russia within the time period stated in the charter of the importing enterprise. See *id.*; see also Decree on the States Customs Committee of the Russian Federation, Dec. 26, 1991 (source on file with the authors); Decree on Customs Duties on Imported Goods, Jan. 15, 1992 (source on file with the authors); Regulations of the Russian Federation State Customs Committee on Customs Duties on Imported Goods, Jan. 22, 1992 (source on file with the authors).

⁴²⁷ See Temporary Regulations on the Import of Foreign Goods into the Russian Federation, Mar. 4, 1992 (source on file with the author). Reportedly, imports from other C.I.S. republics into Russia will not be dutiable under the provisions of the Transit Agreement signed by nine C.I.S. countries. New Russian provisional import duties became effective July 1, 1992 and are in force until the enactment of the Customs Code and import duty tariff regulations. For most items, the duty is 5 percent, but for certain consumer items, such as electronic appliances, automobiles, and liquors, duties range as high as 25 percent. The tariff schedule is based on the country of origin having most-favored-nation (MFN) status with Russia, and the United States has obtained such status under the Trade Agreement with Russia. Goods exported from the countries lacking the MFN status are subject to import duties double the normal rates. Imports of certain commodities, including agricultural products and food from developing countries, are exempted from import duties. In addition, certain goods are completely exempt from customs duties regardless of their country of origin. See *Russia Increases Customs Burden on Imports*, BUSINESS EASTERN EUROPE, Aug. 24, 1992, at 414, available in LEXIS, Europe Library, Bueeur File. The above import regulations were revised once again in August 1992 when new customs regulations were introduced as of September pursuant to the Presidential

sive customs code and tariffs,⁴²⁸ and the U.S.S.R. Customs Tariff has been repealed.⁴²⁹ As the other republics establish their own customs departments, their rules and regulations will supersede the old all-Union customs code, and will probably incorporate the provisions of the Russian customs regulations.

f. *Banking and Credit*

By 1991, the Russian banking system, as well as the banking systems of other republics, was theoretically distinct and separate from the central Soviet banking system.⁴³⁰ The U.S.S.R. Law on Banks and Banking Activities⁴³¹ and its Russian counterpart, the Law on Banks and Banking Activities in the R.S.F.S.R.,⁴³² governed most banking matters. In practice, though, the Russian and all-Union Soviet fiscal affairs were closely intertwined.⁴³³ After bad loan management and illiquidity forced Soviet state-owned banks such as Vnesheconombank to close their doors, Russian President Boris Yeltsin took responsibility for the all-Union budget and banking

Decree No. 825 of August 7, 1992. The new import tariffs are divided into 14 categories and include levying procedures. See Youry Petchenkine, *Regulation of External Economic Activities*, East/West Exec. Guide, Nov. 1992, at 28 (source on file with the authors).

⁴²⁸ See Presidential Decree No. 788 on Urgent Measures to Organize Customs Control in the Russian Federation, July 18, 1992 (source on file with the authors).

⁴²⁹ See Decree No. 32 of the Russian Government on Customs Duties on Imported Goods, Jan. 15, 1992 (source on file with the authors); see also Valery Oreshkin, *What's New in Customs Regulation*, MOSCOW NEWS, May 13, 1992, available in LEXIS, World Library, MOSNWS File.

⁴³⁰ See Hugh Fraser, *A Blank Cheque for Chaos; the Soviet Banking System is Set to Split at the Seams in a Tug of War Between Republics and the Centre*, THE INDEPENDENT, Sept. 1, 1991, at 6, available in LEXIS, Nexis Library, Omni File; Leyla Boulton, *A Fragile Banking System Takes Root*, FIN. TIMES, Mar. 13, 1992, at 28. For the discussion of the Soviet banking system, see generally KATHLEEN J. WOODY, SOVIET BANKING AND FINANCE (1990); Marion M. Hagler, Comment, *Financial Perestroika: A Look At The Recent Soviet Banking Reforms*, 21 LAW & POL'Y INT'L BUS. 53 (1989).

⁴³¹ See U.S.S.R. Law on Banks and Banking Activities, translated in *USSR Legal Materials*, *supra* note 139.

⁴³² The Russian Law on Banking, *supra* note 396; R.S.F.S.R. Central Bank Act 1990, Vedonoski R.S.F.S.R., Dec. 2, 1990, translated in R.S.F.S.R. Central Bank (Bank of Russia) Act 1990, Sov. Legisline, Dec. 2, 1990 (source on file with the authors) [hereinafter Russian Central Bank Law]; see generally William G. Frenkel, *RSFSR Banking Legislation Could Provoke Conflict in the USSR*, 2 COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. 7 (Apr./May 1991) (source on file with the authors).

⁴³³ See U.S.S.R. Law on Banks and Banking Activity and the USSR Law on the State Bank, Dec. 11, 1990; see generally William G. Frenkel, *Soviet Banking Legislation Enacted*, 12 J. INT'L BANKING L. 507 (1990); Joseph L. McCarthy, *In Moscow, a Banking Revolution*, AM. BANKER, Nov. 8, 1991, at 2A, available in LEXIS, Nexis Library, Omni File.

system.⁴³⁴ Vnesheconombank and its foreign subsidiaries continued to function in a limited manner and continued to service their old loans to foreign investors in the U.S.S.R. until 1992, at which time they were reorganized.⁴³⁵

The question of establishing a centralized legal framework for monetary matters in the Commonwealth, however, is now entirely moot until some consensus on a system of central banks is reached between the principal republics. The Russian Federation has already taken the first steps in that direction by reorganizing the former all-Union central bank, Gosbank, through consolidation with the Russian Central Bank.⁴³⁶ Russian banking laws and regulations now exclusively govern banking transactions of companies organized under Russian law or those operating in Russia, including enterprises with foreign investment, the foreign bank branches' creation and operations, and joint venture banking organizations.⁴³⁷

Shortage of outside financing for Russian and other C.I.S. ventures has plagued western investors since the inception of direct foreign investment in the former U.S.S.R. in 1987.⁴³⁸ In light of the instability inherent in the Soviet foreign investment regime and the troubled Soviet—and now Russian—economy, western lenders have been cautious.⁴³⁹ In the past, western commercial banks extended credit to joint ventures in the former U.S.S.R. on the strength of sovereign guarantees, but as the Soviet government's credit rating sunk in the last years of its existence, sovereign guaranty lending

⁴³⁴ See Peter Pringle, *Russia Takes Over Soviet Banks to Shore Up Rouble*, THE INDEPENDENT, Nov. 23, 1991, at 14, available in LEXIS, Nexis Library, Omni File. The Soviet attempt to establish a western-style banking system met with trouble before the disintegration of the Union government for a number of profound causes inherent in the structure of the Soviet economy in transition as it existed in 1991 and continued to plague the Russian Federation as it has inherited the collapsed Soviet economy. See Brady, *In the Red*, EUROMONEY, July 1991, at 19-22 (source on file with the authors).

⁴³⁵ See *Vnesheconombank To Be Liquidated in 1992*, BUSINESS EASTERN EUROPE, Dec. 23, 1991, at 469-70, available in LEXIS, Europe Library, Bueeur File.

⁴³⁶ Decree on the U.S.S.R. Bank for Foreign Economic Activity, Jan. 13, 1992 (source on file with the authors); Decree on the Financial Credit Guarantee of Economic Reform and on the Reorganization of the Russian Banking System, Nov. 22, 1991 (source on file with the authors); Presidential Instruction No. 27 on Regulation of the Activity of Financial Organs and Banks in the Territory of the R.S.F.S.R. (source on file with the authors); see Melanie L. Fein, *The Emerging Banking System: An Overview*, 3 East/West Exec. Guide, No. 1, at 24 (Jan. 1993) (source on file with the authors).

⁴³⁷ See Frenkel, *supra* note 432, at 7-8.

⁴³⁸ See, e.g., Brian L. Zimble, *Soviet Foreign Investment Laws and Practices, 1987-1990: A Practitioner's Perspective*, 4 TRANSNAT'L LAW. 85, 108 (1991).

⁴³⁹ *Id.*

transactions became almost non-existent.⁴⁴⁰ The difficulty of financing the initial investment in Russia and other former Soviet republics, and in particular obtaining so-called "seed money" or "venture capital," is compounded by the poor performance of the Russian economy, which suffers from hyperinflation and is burdened by the inconvertibility of the Soviet ruble.⁴⁴¹ Project financing is also difficult to arrange for established and profitably operating ventures because the Russian system of secured lending is so poorly developed.⁴⁴² Finally, even trade finance is suffering because of the unpredictable political and economic environment and the ever-increasing frequency of defaults of both private and public Russian entities.⁴⁴³ Due to the unstable condition of the Russian economy, often the only alternative to internal financing is financing arranged through national and international development banks and export credit government agencies.⁴⁴⁴

Although enterprises with foreign investment and their foreign participants rarely rely on Russian banks for raising funds in foreign currency, providing credit facility in convertible currency, or for performing international documentary transactions, they often use services of Russian banks for domestic banking transactions.⁴⁴⁵ Presently, over 1,600 private commercial banks are operating in Russia

⁴⁴⁰ See generally Lawrence J. Brainard, *Public and Private Credit Policy in East-West Trade*, 7 LAW & POL'Y INT'L BUS. 1169, 1172-73 (1975); Schneider, *Tax, Investment and Financing Issues*, in PROJECTS IN THE U.S.S.R. AND EASTERN EUROPE, at 245-51 (PLI Handbook Series, 1990) (source on file with the authors); Brady, *The Honeymoon is Over*, EUROMONEY, July 1991, at 24-26 (source on file with the authors).

⁴⁴¹ See Brady, *supra* note 440, at 24-26. For an excellent discussion of international lending principles as they apply to the newly independent states of the former U.S.S.R., see McPherson, *A Guide to the Banking for the Commonwealth*, BUSINESS IN THE EX-USSR, Feb. 1992, at 66-67 (source on file with the authors).

⁴⁴² See generally Meriam & Schwartz, *Project Finance in Russia*, Project Finance Supplement to Corporate Finance, July 1992, at 27-33 (source on file with the authors).

⁴⁴³ See *Financing for C.I.S. Sales Still Very Tight*, BUSINESS EASTERN EUROPE, Aug. 24, 1992, at 409-10, available in LEXIS, Europe Library, Bueeur File; *Soviet Payment Delays Now Require That Companies Use Caution in Arranging Terms*, BUS. AM., July 2, 1990, at 12, available in LEXIS, Nexis Library, Omni File; ZIGLER, SOVIET FOREIGN INVESTMENT LAWS AND PRACTICES 109 (source on file with the authors).

⁴⁴⁴ See Weisenfeld, *Specialized Sources of Financing and Political Risk Insurance for Trade and Investment Abroad*, in ALI-ABA Resource Materials: International Trade for the Nonspecialist (3d ed. 1989) (source on file with the authors); Holland, *Techniques for Financing Projects and Investments in the Soviet Union*, in ABA Section of International Law and Practice, Apr. 27, 1990 (source on file with the authors).

⁴⁴⁵ As Russian entities, enterprises with foreign investment, particularly those with extensive internal Russian operations, need the services of Russian banking organizations for executing purely domestic transactions with other Russian entities. The environment of Russian banking

and about 1,000 more operate in other former Soviet republics which complement the state-owned commercial banks, most of which offer some rudimentary banking services.⁴⁴⁶ For complex financial transactions, however, the Russian enterprise with foreign investment must turn to the branches and subsidiaries of western banks in Russia.⁴⁴⁷ It is unclear whether the old Joint Venture Law's borrowing restriction⁴⁴⁸ requiring foreign banks to obtain Vnesheconombank's consent to borrow is still in effect. It is expected that foreign investors and their investment vehicles, such as joint ventures, will be free to secure financing in convertible currency to the extent it may be available. Foreign investors may obtain this currency from Russian and other republican banks, state-owned banks, privately-held commercial banks, or foreign banks. Loans in both rubles and foreign currencies may now be obtained from the variety of newly licensed Russian credit institutions, including private commercial banks duly authorized by the republican central banks to handle foreign currencies.⁴⁴⁹

g. *Currency Regime*

The importance of a currency regime that is attractive to foreign investors can be seen from two principal perspectives: (i) the freedom to transact business operations in both local and foreign currencies in the host country's domestic economy and foreign trade, and (ii) the freedom to repatriate the profits earned in the host country to the country of the foreign investor's domicile and to reinvest them in the host country. Many countries, because of their

today, however, leaves much to be desired even in the sphere of simple financial operations, such as settlements in domestic currency. See Louis Uchitelle, *The Roulette of Russian Banking*, N.Y. TIMES, Feb. 29, 1992, at 37.

⁴⁴⁶ See Melanie L. Fein, *Emerging Russian Banking System is Unique; But Changes To Law May Adopt Western Standards*, RUSSIA & COMMONWEALTH BUS. L. REP., Jan. 1, 1993, at 3, available in LEXIS, Nexis Library, RCBLR File. The Russian banking system lacks many conventional banking services taken for granted in western countries, such as checking accounts, credit cards, and bank transfers, and what it does offer in the way of financial services is usually grossly inefficient, even at privately-held commercial banks. See S. Jan Vukovich, Comment, *East-West Joint Ventures: Lessons from Past Soviet-Western Joint Ventures and Projections for Future Deals with the C.I.S.*, 20 DENV. J. INT'L & POL'Y 439, 465 (1992) (source on file with the authors).

⁴⁴⁷ See generally Fein, *supra* note 436, at 24; William G. Frenkel, *Reforming the Banking Industry in the C.I.S.: The Chicken Before the Egg Dilemma*, 9 J. INT'L BANKING L. 365 (1992); Redway, *Financing Projects in the Territory of the Former USSR*, in LEGAL AND PRACTICAL ASPECTS OF DOING BUSINESS IN THE SOVIET REPUBLICS, at 115 (PLI Handbook Series No. 604, 1992) (source on file with the authors).

⁴⁴⁸ See Soviet Joint Venture Law, *supra* note 351, art. 27.

⁴⁴⁹ See Fein, *supra* note 436, at 25.

foreign exchange controls and other currency regulation legislation restricting certain currency transactions, do not permit foreign investors absolute freedom to engage in those investment activities. This is certainly the case in the Russian Federation, where a number of limitations on internal and external currency transactions exist. In addition, the inconvertibility of the Russian ruble has traditionally presented a major obstacle to transferring profits and dividends abroad.

Although not free from ambiguity, the legal and economic developments in the Russian Republic in 1992 indicate that the Russian currency regulation regime is being substantially liberalized. In contrast to the restrictive former all-Union currency regime, many of the former Soviet foreign currency ownership and transactional restrictions will be lifted.⁴⁵⁰ The basis for such assumptions could be found in the draft of the Russian Law on Currency Regulation as prepared by the Russian parliament and in several decrees issued by President Yeltsin.⁴⁵¹ In particular, several different exchange rates for the ruble, which had been set by Vnesheconombank under Soviet law, are consolidated in the Russian Republic into a single exchange rate determined by the R.S.F.S.R. Central Bank on the basis of the prevailing currency market conditions.⁴⁵² This change reflects the Russian Republic's determination to proceed with speedy economic reforms toward a convertible Russian currency.⁴⁵³

Certain restrictions on foreign currency operations, however, are likely to be retained.⁴⁵⁴ For example, the Russian Republic will probably retain the restrictions recently announced by the Russian gov-

⁴⁵⁰ See Robert E. Langer & Melissa J. Schwartz, *Hard Currency Regulation*, East/West Exec. Guide, Dec. 1992, at 21-22 (source on file with the authors).

⁴⁵¹ See *Parliament Resumes Debate on Currency Law*, KOMMERSANT, Sept. 29, 1992, at 25 (source on file with the author).

⁴⁵² See Presidential Decree on Liberalizing Foreign Economic Activity, Nov. 15, 1991, BBC; Summary of World Broadcasts, Nov. 19, 1991, available in LEXIS, Nexis Library, Omni File [hereinafter Foreign Investment Decree].

⁴⁵³ See generally Vasily Soldatov, *Russia's Currency Market: Problems and Prospects for its Development*, RUSDATA DIALINE-BIZEKON NEWS, Jan. 16, 1992, available in LEXIS, Nexis Library, Omni File. But see Byron, *Save the Bear: the Collapsing Rouble*, Jan. 13, 1992, at 8 (source on file with the authors).

⁴⁵⁴ See Decree on Liberalization of External Economic Activity in the R.S.F.S.R. Territory, Nov. 15, 1991, art. 8 [hereinafter Nov. 15 Decree]. Although this prohibition on domestic transactions in foreign currency was supposed to go into effect on July 1, 1992, certain foreign currency transactions within Russia were still reportedly tolerated and not expressly prohibited in Russia as of late 1992. Eventually, though, the use of foreign currency in internal transactions in Russia should subside as the foreign exchange markets become self-sufficient and the value of the ruble against hard currencies stabilizes. See Youry Petchenkine, *New Currency Regulations*, East/West Exec. Guide, Sept. 1992, at 25-27 (source on file with the authors).

ernment concerning internal payment and settlement in foreign currencies to combat the "dollarization" of the Russian economy.⁴⁵⁵ This is seen as an essential measure to protect the ruble against devaluation and to move toward internal convertibility of the ruble. There are some exceptions to prohibition on payment in foreign currency in domestic transactions, such as payment of wages and salaries within the Russian republic and duly licensed retail trade.⁴⁵⁶ Although it is unclear at this time, the repatriation of foreign investors' profits should not be affected by this measure directly, especially if access to foreign currency exchange is improved.⁴⁵⁷

Although sales within the former Soviet Union generally may still be made for both rubles and foreign currency, the regulations first issued under the U.S.S.R. Law on Currency Regulation⁴⁵⁸ substantially curtailed the internal circulation of foreign currency.⁴⁵⁹ Russian regulation of internal currency transactions that began in 1991, however, is undergoing broad liberalization vis-à-vis the previous Soviet currency regime.⁴⁶⁰ Russian citizens and legal entities are no longer restricted in their purchases and sales of foreign currencies

⁴⁵⁵ See *Yeltsin Bans Hard Currency Transactions*, East/West Business Report, Jan. 31, 1992, at 25, 26 (source on file with the authors).

⁴⁵⁶ *Id.*

⁴⁵⁷ For the analysis of foreign investors' right to remit abroad profits, dividends, and other payments associated with doing business in Russia, see discussion *infra* part I.

⁴⁵⁸ See U.S.S.R. Law on Currency Regulation, Mar. 1, 1991, reprinted in Foreign Broadcast Information System, *National Affairs*, FBIS-SOV-91-057 (Mar. 25, 1991) (source on file with the authors); see also William G. Frenkel et al., *The New Soviet Currency Regime*, 9 INT'L CO. & COM. L. REV. 306, 306-10 (1991). The Gosbank Regulations will be in force in the Russian Federation until the Central Bank of Russia issues its new regulations.

⁴⁵⁹ See U.S.S.R. Law on Currency Regulation, *supra* note 458.

⁴⁶⁰ See Decree of the President of the Russian Federation On a Partial Change in the Procedure for the Requisite Sale of a Portion of Hard Currency Earnings and on the Retrieval of Export Tariffs, No. 629, June 14, 1991 (source on file with the authors); Decree of the President of the Russian Federation On the Measures on the Protection of the Monetary System of the Russian Federation, No. 636, June 21, 1992 (source on file with the authors); Instruction of the Central Bank of the Russian Federation (Bank of Russia) On the Procedure of the Mandatory Sale by Enterprises, Associations and Organizations of a part of Hard-Currency Receipts through Authorized Banks and on the Procedure for Conducting Operations on the Internal Hard Currency Market of the Russian Federation, No. 7 (includes implementing Order of the Central Bank of the Russian Federation (Bank of Russia) No. 02-104a, June 29, 1992 (source on file with the authors)); Decree of the Government of the Russian Federation On the Hard Currency Economic Commission of the Government of the Russian Federation, No. 43, June 30, 1992 (source on file with the authors); Order of the Central Bank of the Russian Federation On the Exchange Rate of Foreign Hard Currencies on 10 July 1992, July 9, 1992 (source on file with the authors); Law of the Russian Federation On Hard Currency Regulation and Hard Currency Control, July 29, 1992 (source on file with the authors).

through authorized banks and are permitted to earn, hold, and dispose of foreign currency lawfully obtained in Russia or abroad.⁴⁶¹ To protect the value of the ruble during its transformation toward full convertibility on international capital markets, however, most internal settlements and payments, except salaries, will only be paid in domestic currency.⁴⁶² Foreign trade transactions may still be carried out in any foreign currency.⁴⁶³ The exchange rates for foreign currencies are no longer arbitrarily fixed by the Gosbank, now absorbed into the Russian Central Bank. Rather, they are determined by supply and demand factors prevailing on the Russian inter-bank currency market, which includes auctions, stock exchanges, and commercial banks.⁴⁶⁴ The Central Bank of Russia is now in charge of indirectly regulating the exchange rates through various market and regulatory mechanisms.⁴⁶⁵

Under the Russian Foreign Investment Law, most of the revenue in hard currency from export sales may be retained by the enterprise with foreign investment.⁴⁶⁶ In general, under the literal reading of the Russian Foreign Investment Law, enterprises with at least 30 percent foreign participation were not subject to the mandatory buy-back of convertible currency provisions of the former Soviet law.⁴⁶⁷ These buy-back provisions substantially depleted the hard currency reserves of domestic enterprises and frustrated the efforts of enterprises with foreign investment to transfer profits and dividends abroad. A number of new Russian currency enactments now contain provisions for deductions to the Russian convertible currency fund to be made by all Russian enterprises and organiza-

⁴⁶¹ Liberalization Decree, *supra* note 415, art. 5.

⁴⁶² See *id.* art. 8; see also Shepherd, *Russian Government Bows to Reality, OKs Foreign Currency Wages*, Associated Press, July 14, 1992 (source on file with the authors); Gerald Nadler, *Yeltsin Looks To Stop Russia's 'Dollarization'*, WASH. TIMES, Oct. 7, 1992, at A7.

⁴⁶³ See *New Currency Law, Other Legal Acts Regulate Use of Foreign Currency in Russia*, RUSSIA & COMMONWEALTH BUS. L. REP., Nov. 30, 1992, at 7, available in LEXIS, Nexis Library, RCBLR File.

⁴⁶⁴ Nov. 15 Decree, *supra* note 454, art. 5; see also *Single Rouble Takes Effect*, Doing Business in Eastern Europe, July 21, 1992, at 137 (source on file with the authors).

⁴⁶⁵ See *Russian Regulations May Force Foreign investors to Revamp Hard Currency Transactions*, RUSSIA & COMMONWEALTH BUS. L. REP., Mar. 6, 1992, available in LEXIS, Nexis Library, RCBLR File [hereinafter *Russian Regulations*].

⁴⁶⁶ See Russian Foreign Investment Law, *supra* note 158, art. 25. But see *infra* note 470 and accompanying text for latest developments in the exemption of an enterprise with foreign investment from mandatory exchange of foreign currency earned through its export sales.

⁴⁶⁷ See Article 15(2) of the U.S.S.R. Currency Regulation Law. Indeed, Soviet currency laws and regulations, which governed foreign currency transactions in Russia until late 1992, were consistent with this provision of the Russian Foreign Investment Law.

tions.⁴⁶⁸ No exemption for enterprises with foreign investment are provided in these decrees, in contravention of the Russian Foreign Investment Law.⁴⁶⁹ New Russian currency enactments⁴⁷⁰ also effectively removed exemptions for foreign investors from the mandatory buy-back of convertible currency, which directly contradicted provisions of the Russian Foreign Investment Law.⁴⁷¹ Under the new regulations, enterprises with foreign investment, either partially or wholly foreign-owned, are required to sell 50 percent of their convertible currency revenue to the state for rubles.⁴⁷² The exchange

⁴⁶⁸ See Decree No. 335 of the President of the Russian Federation of December 30, 1991 Concerning the Formation of the Republican Currency Reserve of the Russian Federation in 1992. The Decree provides for a compulsory sale of 40 percent of receipts in hard currency to the Republican Currency Reserve at the special commercial exchange rate (50 percent of auction rate). See *id.* art 1. Further, the decree provides for the sale of an additional 10 percent of hard currency receipts to the Central Bank of the Russian Federation at the market exchange rate. See *id.* art 5. The latter provision apparently applies to foreign owned entities as well as those owned exclusively by Russian citizens. *Id.* Furthermore, January 22, 1992 Instruction of the Russian Central Bank established an exemption from the mandatory 40 percent currency sale for foreign owned companies and joint ventures with greater than 30 percent foreign ownership. No such exemption exists from the 10 percent compulsory sale applicable to all entities registered in Russia. The Russian government has also created a new agency to deal specifically with the problems of foreign currency shortage, Russian balance of payments, credit guarantees, settlement of foreign debt, and foreign investment. See Decree on the Establishment of the Currency and Economic Council of the Russian Federation, Nov. 28, 1991. One of the Council's primary responsibilities, however, is to distribute and control the funds in convertible currencies received by the Russian currency reserve fund. See *On the Currency and Economic Council of the Russian Federation*, SOVDATA DIALINE-BIZEKON NEWS, Dec. 10, 1991, available in LEXIS, Nexis Library, Omni File.

⁴⁶⁹ The Russian law thus retained the compulsory buy-back rule originated by the Soviet Currency Law, which required Soviet companies with less than 40 percent foreign ownership to sell a part of their convertible currency profits back to the government fund. See Decree of the President of the Russian Federation on the Formation of Republican Currency Reserve of the Russian Federation in 1992, Dec. 30, 1991, reprinted in ROSSIISKAYA GAZETA (Debevoise & Plimpton, trans. Jan. 7, 1992); Instruction of the State Bank of the Russian Federation, No. 3, Jan. 22, 1992 (*Kommersant* No. 4, 1192, Jan. 20-27. Russian ed.).

⁴⁷⁰ Decree No. 629 on a Partial Change in the Policy on Mandatory Sale of Part of Foreign Currency Revenue and Imposition of Export Duties, June 14, 1992 (source on file with the authors); Instruction No. 5 of the Central Bank of Russia on Mandatory Sales of Convertible Currency Export Revenue.

⁴⁷¹ See, e.g., Russian Foreign Investment Law, *supra* note 158, art. 26.

⁴⁷² Similar to the former Soviet Currency Regulation Law, the Russian law originally entitled enterprises with foreign investment to certain exemptions. See *Russian Regulations*, *supra* note 465, at 3; *Russian Central Bank Modifies Currency Regulations to Expand Exemptions*, RUSSIA & COMMONWEALTH BUS. L. REP., Apr. 20, 1992, at 5, available in LEXIS, Nexis Library, RCBLR File. The Russian law originally changed the amounts to be contributed to the fund: foreign investment enterprises must sell 40 percent of the gross receipts from the export sales to the fund at the commercial exchange rate, and must sell 10 percent of the gross receipts in convertible currency to the Russian Central Bank at the commercial exchange rate. *Id.*; see *Hard Currency Regulations Remove Exemptions for Foreign Investors*, RUSSIA & COMMONWEALTH BUS. L. REP., Aug. 24, 1992, at 3, available in LEXIS, Nexis Library, RCBLR File [hereinafter *Hard Currency*].

rate to be applied to this mandatory buy-back, however, will be the market rate, rather than the previous special commercial rate.⁴⁷³ The Russian Currency fund will be instrumental in paying an estimated \$80 billion Soviet foreign debt, 80 percent of which the Russian Republic assumed.

By the end of 1992, Russian currency law had undergone additional changes and refinements. First, a new law on currency regulation was adopted, replacing the Soviet Law on Currency Regulation and Control, although the Central Bank of Russia has not yet issued regulations implementing its broad provisions.⁴⁷⁴ As noted, the artificially low commercial exchange rate has been eliminated, various exchange rates were consolidated into a single market-determined rate,⁴⁷⁵ and the ruble has been allowed to float.⁴⁷⁶ While in theory foreign investors may exchange all of their ruble revenue into foreign currency in domestic Russian currency markets for repatriation, in reality, demand for convertible currency far exceeds its supply. This imbalance will continue to obstruct the repatriation of funds until the ruble becomes stronger.⁴⁷⁷

The Russian Foreign Investment Law also provides a special ad-

⁴⁷³ *Hard Currency*, *supra* note 472.

⁴⁷⁴ See Changes in Russian Law on Currency Regulation & Currency Control, *reprinted in* ROSSIISKAYA GAZETA, Nov. 4, 1992, at 5, and *translated in* KOMMERSANT, Oct. 20, 1992, at 26 (source on file with the authors). Until implementing regulations have been enacted thereunder, however, the law does not appear to contain any radical departures from the current currency regime described in this article. See generally William G. Frenkel, *Russia's Own Law on Currency Regulation Adopted In An Effort To Better Manage Currency Resources*, 3 COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. 1-5 (Dec. 1992).

⁴⁷⁵ At numerous occasions, the Russian government made announcements of its intention to introduce special exchange rates, such as the one for privatization buyouts by foreign investors, which has never been adopted. Some analysts truly wonder whether this new single market exchange rate will last. Although the various exchange rates established by the Gosbank for different transactions are no longer valid in Russia and are consolidated into one unified exchange rate, there is still a possibility that for certain investment transactions and compulsory sales of convertible currency foreign investors will be forced to employ the so-called commercial rate of exchange. See *supra* notes 463-465 and accompanying text; *Higher Foreign Investment Rate Considered*, RUSSIA & COMMONWEALTH BUS. L. REP., May 15, 1992, available in LEXIS, Nexis Library, RCBLR File. Furthermore, officials of the Central Bank of Russia under Chairman Geraschenko intimated that the Central Bank may reintroduce a fixed-rate exchange system for the ruble sometime in 1993, which would not be pegged directly to the results of the bi-weekly currency exchange operations at the Moscow Interbank Exchange, as is done now. See *New Exchange Regime for Rouble*, BUSINESS EASTERN EUROPE, Dec. 21, 1992, at 636, available in LEXIS, Europe Library, Bueeur File.

⁴⁷⁶ See *Foreign Investors to be Allowed to Exchange Dollars at Market Rate*, 2 E. Eur. Rep. (BNA) No. 10, at 370 (May 11, 1992), available in LEXIS, BNA Library, EERPT File.

⁴⁷⁷ See O'Brien, *Russia Sets Date for Making Ruble Convertible*, Associated Press, May 5, 1992 (source on file with the authors); Vladimir Gurevich, *Fixing the Rate*, MOSCOW NEWS, Oct. 7, 1992, available in LEXIS, World Library, Mosnws File.

vantage for enterprises with foreign investment turning out "import substituting products of high importance to the national economy."⁴⁷⁸ Such enterprises need not acquire foreign currency at the market (auction) rates—which tends to make purchases of foreign currency for rubles considerably more costly.⁴⁷⁹ Instead, these enterprises may use a "mutually coordinated rate" for the purpose of transferring ruble profits abroad, drawing on the R.S.F.S.R. Currency Fund.⁴⁸⁰ While the major policies behind the Russian currency regime are likely to be enforced in other republics in order to pursue the stabilization of the ruble, the terms and conditions for the mandatory buy-back regime, the foreign currency auctions, and the interbank markets still vary.⁴⁸¹ Moreover, foreign investors may now participate in the Russian currency market to exchange their profits and dividends from rubles to convertible currencies.⁴⁸² Russian legal entities may convert rubles into foreign currencies only for the purpose of importing goods and services.⁴⁸³ The market exchange rate of the ruble recently plummeted to nearly R700 per \$1.⁴⁸⁴ The Russian Law on Currency Regulation also regulates currency transactions denominated in rubles.⁴⁸⁵

h. *Taxation*

Taxation of foreign investors' business operations, profits, and dividends is undoubtedly one of the primary criteria in assessing the attractiveness of the host country. The legal regime regulating taxation in Russia recently underwent major changes and remains one of the most volatile areas of Russian law. At first glance, foreign investors fared no better under the new Russian regime than they

⁴⁷⁸ See Russian Foreign Investment Law, *supra* note 158, art. 11.

⁴⁷⁹ See *Single Rate of Exchange for Ruble Introduced July 1*, E. Eur. Rep. (BNA) No. 15, at 532 (July 20, 1992), available in LEXIS, BNA Library, EERPT File.

⁴⁸⁰ *Id.* The author is not aware of any specific instance where foreign investors were in fact allowed to utilize this special foreign exchange arrangement and in light of the new currency policy of the Russian government reflected in the consolidation of multiple exchange rates into a single, market driven exchange rate for the rouble, it is probably no longer available.

⁴⁸¹ See generally *Foreign Exchange Rules in the Former USSR*, BUSINESS EASTERN EUROPE, July 20, 1992, at 350–51, available in LEXIS, Europe Library, Bueeur File.

⁴⁸² But see *New Central Bank Chairman Says Convertible Ruble Not Yet Realistic*, E. Eur. Rep. (BNA) No. 16, at 626 (Aug. 3, 1992), available in LEXIS, BNA Library, EERPT File.

⁴⁸³ See *Recent Government Steps Restrict, Clarify Uses of Foreign Currencies*, E. Eur. Rep. (BNA) 999 (Dec. 7, 1992), available in LEXIS, BNA Library, EERPT File.

⁴⁸⁴ *Id.*

⁴⁸⁵ *Id.*

did under the previous Soviet regime.⁴⁸⁶ This view, however, although justified from the point of view of various tax exemptions and holidays previously granted to the foreign investor in the heyday of the Soviet perestroika, would be fully misleading and overly simplistic in view of the complexity of the present Russian tax regime. This is especially true, when one considers the transnational implications of deriving Russian-source income under the applicable double-taxation treaties.⁴⁸⁷

Until 1992, taxation of enterprises with foreign investments in the Russian Federation was made on the basis of the Law on Application of the U.S.S.R. Law on Taxes on Enterprises, Associations, and Organizations (Russian 1991 Enterprise Tax Law),⁴⁸⁸ which largely incorporated the U.S.S.R. Law on the Taxation of Enterprises, Associations, and Organizations (Soviet Enterprise Tax Law),⁴⁸⁹ with the amended tax rate schedules.⁴⁹⁰ In other republics of the Commonwealth, either their own tax laws are in effect or the all-Union tax law still prevails.⁴⁹¹

With respect to all Russian legal entities, including enterprises

⁴⁸⁶ For the discussion of the Soviet tax holidays and incentives, which have been repealed from the Russian tax law, see E.H. Lieberman et al., *New Soviet Tax Laws Attract Foreign Investors*, J. INT'L TAXATION 278, 281 (Jan./Feb. 1991).

⁴⁸⁷ For the discussion of the U.S.-Russia Tax Treaty, see generally Michael Newcity, *Convention Between the United States of America and the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital*, 3 COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. 7 (Oct. 1992) (source on file with the authors).

⁴⁸⁸ Law on Application of the U.S.S.R. Law on Taxes on Enterprises, Associations, and Organizations of Dec. 1, 1990, reprinted in EKON. I ZH., Jan. 1991, No. 1, at 22; see generally Stephan, *supra* note 16, at 746-47; see also Michael Newcity, *Taxation in the Former Soviet Union: An Interim Report*, Tax Planning Int'l Rev. (BNA) 3 (1992).

⁴⁸⁹ Law of the U.S.S.R. On the Taxes on Enterprises, Associations, and Organizations, VSND & VSS SSSR, No. 27, Item 522 (1990), reprinted in IZVESTIYA, June 30, 1990 at 1-3 and translated in Foreign Broadcast Info. Serv. SOV-90-135 (July 13, 1990), at 45 (source on file with the authors); see generally Alexander E. Lloyd, Note, *U.S.S.R. Law on Taxation of Enterprises, Associations, and Organizations: What Does It Mean for Western Investment in the Soviet Union*, 44 TAX LAW. 1123 (1991).

⁴⁹⁰ See R.S.F.S.R. Law on the Taxation of Enterprises, Associations, and Organizations, Dec. 2, 1991 (1991 Enterprise Tax Law), reprinted in EKON. I ZH., Jan. 1991, at 2 (source on file with the authors); R.S.F.S.R. Law on the Procedure for Applying on the R.S.F.S.R. Territory in 1991 the U.S.S.R. Law on the Taxation of Enterprises, Organizations, and Associations (source on file with the authors); see also Introducing on RSFSR Territory Interim Procedure for Levying Taxes on Enterprises, Associations, Organizations and Citizens Vedomosti R.S.F.S.R., Apr. 19, 1991, Decree No. 10-43-1, translated in *Introducing on R.S.F.S.R. Territory Interim Procedures for Levying Taxes on Enterprises, Associations, Organizations and Citizens*, SOVDATA DIALINE-BIZEKON NEWS, Apr. 17, 1991, available in LEXIS, World Library, Sovleg File.

⁴⁹¹ See Newcity, *supra* note 488, at 3.

with foreign capital or joint venture companies, the Russian 1991 Enterprise Tax Law imposed six different income-based and non-income based taxes: (1) profits tax; (2) turnover tax; (3) export/import tax; (4) consumption tax; (5) investment income tax; and (6) entertainment tax.⁴⁹² These were largely similar to and based on the Soviet all-Union taxes previously imposed by the central tax authorities.⁴⁹³

Under the Russian 1991 Enterprise Tax Law, joint venture companies were still entitled to special tax benefits.⁴⁹⁴ For example, if the foreign ownership of a joint venture exceeded 30 percent, that enterprise was eligible for a lower profits tax rate: 30 percent instead of the 45 percent applicable to domestic enterprises.⁴⁹⁵ Under the Russian 1991 Enterprise Tax Law, the applicable tax rate was 35 percent for domestic enterprises, 32 percent for joint stock associations, 25 percent for wholly owned foreign stock associations, and 25 percent for joint ventures with more than 30 percent foreign ownership.⁴⁹⁶ The joint ventures above the 30 percent ownership threshold also qualified for special deductions and loss carryforwards, as well as a two-year tax holiday.⁴⁹⁷ Both the Soviet and Russian tax laws provided a 15 percent withholding rate on all profits repatriated abroad.⁴⁹⁸

In order to streamline the tax legislation, the Russian parliament recently adopted a new Russian tax code.⁴⁹⁹ Three new laws were enacted as part of the new tax code: the Law on Value-Added Tax (establishing a 28 percent tax rate),⁵⁰⁰ the Law on the Taxation of Profits of Enterprises and Organizations (Russian Profits Tax Law)

⁴⁹² See Arthur L. George & Thomas A. O'Donnell, *Business Operations in the U.S.S.R.*, 990 T.M., at A-36-A-37 (BNA Tax Management Portfolio) (1991).

⁴⁹³ See generally Michael Newcity, *Tax Issues in Soviet Joint Ventures*, 25 TEX. INT'L L. J. 163 (1990); Michael Newcity, *Tax Considerations in Foreign Trade and Investment in the USSR*, 24 VAND. J. TRANSNAT'L L. 235 (1991).

⁴⁹⁴ See George & O'Donnell, *supra* note 492, at A-53-A-57.

⁴⁹⁵ *Id.*

⁴⁹⁶ *Id.*

⁴⁹⁷ *Id.*

⁴⁹⁸ *Id.*

⁴⁹⁹ See *Russia Adopts New Tax Laws, within Ukraine's Law on Partnerships Sets Procedures for Joint Stock Company*, SOVIET BUS. L. REP., Jan. 10, 1992, available in LEXIS, Nexis Library, RCBLR File.

⁵⁰⁰ See Law of the Russian Federation On the Introduction of Changes and Additions to the R.S.F.S.R. Law "On Tax on Added Value," No. 2813-1, May 22, 1992 (source on file with the authors); see also Pekowsky & Hagler, *Recent Taxation Developments Discussed*, Doing Business in Eastern Europe (CCH) 93, 95 (May 1992).

(a transitional enactment),⁵⁰¹ and the Law on the Taxation of Incomes of Enterprises (Russian Income Tax Law)⁵⁰². The Russian Profits Tax Law went into effect on January 1, 1992, but was supposed to be superseded during 1992 by the Russian Income Tax Law.⁵⁰³ The change, if effected in 1992, will lower the statutory tax rate, as well as alter the tax base.⁵⁰⁴ Until that change takes effect, the effective tax rate on profits of most Russian companies,⁵⁰⁵ including enterprises with foreign investment and foreign companies, is 32 percent.⁵⁰⁶ Intermediary and trading companies are taxed at the

⁵⁰¹ See Law of the Russian Federation On the Tax on Profit of Enterprises and Organizations, No. 2116-1, and implementing decree, Dec. 27, 1991 (source on file with the authors); see also Pekowsky & Hagler, *supra* note 500, at 94.

⁵⁰² See Law of the Russian Federation On Income Tax on Enterprises, Dec. 20, 1991. In addition, the Law on the Fundamentals of the Tax System in Russia, the Law on Investment Tax Credit, and the Law on Taxation of Income from Insurance Activities have been passed as part of the new Russian tax code. See also Decree of the President of the Russian Federation On the Russian Federation State Tax Service, Dec. 31, 1991; Instructions for Application of the Law of the R.S.F.S.R. On Income Tax on Physical Entities, Mar. 20, 1992; Instructions on the procedure of calculation and payments to the budget of the tax on the income from insurance activities, No. 9, Mar. 26, 1992; Instruction of the State Tax Service of the Russian Federation On Investment Tax Credit, Apr. 28, 1992; Instruction of the State Revenue Board of the Russian Federation for Taxation of Profit and Income of Foreign Juridical Persons, No. 13, May 27, 1992; Decree of the Supreme Soviet of the Russian Federation On the Introduction of Changes into the Decrees of the Supreme Soviet of the Russian Federation on Questions of Taxation, Aug. 1992; Decree of the Supreme Soviet of the Russian Federation On Several Questions on the Tax Legislation of the Russian Federation, Aug. 1992; Law of the R.S.F.S.R. On Taxation on Property of Enterprises, No. 2030-1, Dec. 13, 1991; see also Pekowsky & Hagler, *supra* note 500, at 94 (all above sources on file with the authors); *Parliament Enacts New Laws on Income, Profits, VAT Taxes*, E. Eur. Rep. (BNA) No. 2, at 42 (Jan. 20, 1992), available in LEXIS, BNA Library, EERPT File.

⁵⁰³ See Steven J. Leider, *Russian Profits Tax Law Emerges As Start of New Tax Regime in Russia*, RUSSIA & COMMONWEALTH BUS. L. REP., Apr. 20, 1992, at 3, available in LEXIS, Nexis Library, RCBLR File. Although the Russian Income Tax Law was supposed to take effect on May 1, as of late 1992, this has not happened, and the Russian Profits Tax Law continues to govern.

⁵⁰⁴ Under The Russian Profits Tax Law, the tax rate is 32 percent, the tax base consists of the taxpayer's profits and wages, and other employee costs are deductible; under the Russian Income Tax Law, the tax rate will be 18 percent, the base will consist of the taxpayer's income and wages, and employee costs will not be deductible. Under the Russian Income Tax Law, taxable income is defined as gross income (income from business operations minus the amount of value added tax and excise tax payable on such operations) less certain expenses, a list of deductions is to be approved by the Russian Supreme Soviet. Certain interest paid on bank loans, property taxes, land taxes, and other miscellaneous taxes may also be deducted. See Mannick, *Tax Environment Substantially Changed With New Legislation*, East/West Exec. Guide, Feb. 1991, at 24 (source on file with the authors).

⁵⁰⁵ Profits are defined in the law as gross income less cost of operations. See Youry Petchenkine, *A Guide to the Profits Tax on Foreign Entities and the U.S.-Russia Tax Treaty*, East/West Exec. Guide, Dec. 1992, at 22 (source on file with the authors).

⁵⁰⁶ *Id.*

45 percent profits rate.⁵⁰⁷ After the transitions to the income tax system, the general tax rate will be set at 18 percent of gross income for most business activities.⁵⁰⁸ Dividend income received by foreign legal entities from their Russian investments will be taxed at 15 percent.⁵⁰⁹ If a foreign company is found to be "doing business" in Russia, whether through direct operations or through a joint venture company, subsidiary, branch, or representative office, its profits may become subject to the current 32 percent tax rate.⁵¹⁰ Thus, unlike the Soviet Joint Venture Law and early Russian tax legislation,⁵¹¹ the new Russian tax laws offer no special tax benefits to joint ventures or other enterprises with foreign investment.⁵¹²

⁵⁰⁷ *Id.*

⁵⁰⁸ Gross income is defined in the law as total gains from the sale of goods or services less the value-added tax, property tax, and any applicable excise duties. *See id.*

⁵⁰⁹ *Id.*

⁵¹⁰ "Doing business" is generally defined in international tax law through the concept of a "permanent establishment" as operating in the host country through a permanent office or a local agent. *See* JON E. BISCHER & ROBERT FEINSCHREIBER, FUNDAMENTALS OF INTERNATIONAL TAXATION 261-62 (1985). Relief from double taxation (that is, taxation by both the host country and by the investor's home country) may be sought by foreign companies operating in the Russian Federation in the bilateral tax treaties which reduce or eliminate the withholding tax rate on dividends and other Russian source income and provide for creditability of certain foreign taxes paid by the local investor. The Russian Federation has concluded such a tax treaty with the United States on June 17, 1992, the Convention Between the United States of America and the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Capital (Tax Treaty), which will replace the 1973 U.S.-U.S.S.R. Tax Treaty upon ratification by the U.S. Congress and which closely mirrors the O.E.C.D. Model Treaty. *See Tax Treaties: Russia/U.S.*, WORLD TAX REPORT, Aug. 1992, available in LEXIS, World Library, WLDTax File. The Tax Treaty provides the definition of a "resident of a Contracting State," which refers to domestic tax law of the host country. *See* Tax Treaty, *supra*, art. 4. The Tax Treaty also provides the definition of a "permanent establishment" which employs the conventional formula traditionally utilized by the U.S. Treasury Department in negotiating tax treaties with other countries. *See id.* art. 5. The Tax Treaty generally reduces the Russian withholding tax on repatriated dividends or profits to 5 percent from the standard 15 percent. *See id.* art. 10. Interest and royalty income is completely exempt from Russian income tax. *See id.* art. 11. The Tax Treaty also governs important questions of creditability of Russian income taxes paid by a U.S. investor in the United States and provides some limited relief from double taxation by allowing such U.S. investor to deduct income tax paid in Russia from its U.S. income tax liability. *See id.* art. 22 and Protocol to the Tax Treaty. For a more comprehensive analysis of the Tax Treaty and its ramifications for the U.S. investor in Russia, see Newcity, *supra* note 487, at 7.

⁵¹¹ Various tax holidays and incentives, such as exemption from profits tax and lower tax rates, were available under the Joint Venture Law and Law on the Procedure for Applying the Law of the U.S.S.R. Concerning Taxes on Enterprises, Associations, and Organizations in the R.S.F.S.R. in 1991, see *supra* notes 117-19, which have been completely eliminated from the new Russian tax law.

⁵¹² Joint ventures with foreign capital engaged in the manufacturing activities which were registered prior to January 1, 1992, however, will continue to enjoy the tax benefits accorded joint enterprises under the former Soviet law. *See Material Production Joint Ventures in Russia*

If the 1992 state budget is approved, the following rates of tax on income of enterprises subject to the Russian law will apply: 18 percent general rate for all types of enterprises (including representative offices of foreign firms); 15 percent rate for enterprises with foreign investment and foreign legal entities with dividend, interest, royalty, and other income from Russian sources; 25 percent rate for enterprises engaged in auditing and consulting activities; 45 percent rate for enterprises engaged in brokerage, trading, and investment services, as well as public entertainment; and 70 percent for auctions, casinos, video rental shops, and gambling operations.⁵¹³ As of the end of 1992, nonetheless, Russian tax law has not stabilized and the current rate structure remains unclear.⁵¹⁴

i. *Labor Relations*

Labor relations, including hiring/firing, work and leisure regime, and compensation of Russian nationals employed by enterprises with foreign investment are generally regulated by the collective labor agreement and individual employment contracts.⁵¹⁵ Employment agreements, however, are also subject to Russian labor legislation.⁵¹⁶ Under the Russian Foreign Investment Law, terms of such agreements may not provide for lesser protection of the workers than the Russian labor law.⁵¹⁷ Although this appears to allow enterprises with foreign investment to fashion their own compensation

Accorded Tax Privileges, RUSSIAN INFO. INC., July 15, 1992, available in LEXIS, Nexis Library, RCBLR File. Thus, these joint venture companies will be eligible for the exemption from profits tax for the first two years following their first balance sheet profits; furthermore, those joint ventures operating in the far eastern region of Russia will be entitled to the three-year tax holiday. *Id.*

⁵¹³ See Mannick, *Tax Environment Substantially Changed With New Legislation*, East/West Exec. Guide, Feb. 1991, at 24 (source on file with the authors).

⁵¹⁴ The profits tax remains the primary enterprise tax on Russian entities and foreign firms doing business in Russia, and the expected transitions to the income tax regime have not been implemented. See Shane R. DeBeer, *Making Sense of Russian Taxes*, INT'L FIN. L. REV., at 36-38 (Oct. 1992). Due to its complexity and volatility, a comprehensive analysis of Russian taxation law is outside the scope of this article.

⁵¹⁵ Considerable flexibility appears to exist in the area of labor relations permitting the foreign investor to solve most issues of employment of Russian nationals through contract subject to limitations imposed by the R.S.F.S.R. Labor Code. See Russian Foreign Investment Law, *supra* note 158, art. 33.

⁵¹⁶ R.S.F.S.R. Labor Code; see OSAKWE, *supra* note 77, at 14-11. The Russian labor law, insofar as it is largely based on the former Soviet labor law, which regulated employer-employee relationships in the conditions of a centrally-planned command economy, is wholly unsuitable for regulating that relationship under market conditions. See generally Vadislav Egorov, *The Reform of Soviet Labor Legislation: Problems and Prospects*, 28 COLUM. J. TRANSNAT'L L. 263 (1990).

⁵¹⁷ Russian Foreign Investment Law, *supra* note 158, art. 33.

packages to Russian employees and reward them with salaries, bonuses, and corporate perquisites subject to no legal restrictions in the way state-owned enterprises cannot, disciplining Russian employees is fraught with difficulties.⁵¹⁸ Employment and termination of Russian nationals, is regulated by the arcane provisions of the R.S.F.S.R. Labor Code⁵¹⁹ and may present serious difficulties for the employer.⁵²⁰ Furthermore, the activity of labor unions and the applicability of collective labor agreements are regulated by the relevant Russian law.⁵²¹

All enterprises created under Russian law must also make withholdings/payments toward the state social security fund.⁵²² In particular, the Russian Law on Employment and Social Protection of Citizens of the R.S.F.S.R. outlines the duties of employers to provide employment on the basis of certain local or regional quotas, to provide training and retraining, to pay the minimum wage, to give advance notice of termination or a layoff, and to pay workers compensation for work-related injuries.⁵²³ Foreign workers may be employed on such terms as they and the company may agree and are not covered by the Russian social security funds.⁵²⁴

j. *Acquisition of Existing Russian Enterprises—Securities, Antitrust, and Privatization Regimes*

In addition to founding new Russian enterprises with foreign investment, foreign investors may also be interested in acquiring existing Russian enterprises. An enterprise with foreign investment is one in which the foreign investor has either paid for its ownership interest with foreign currency, or paid in rubles but has more than a 50 percent ownership share.⁵²⁵ Foreign investors may acquire a participation share, an ownership interest, shares of stock, and other

⁵¹⁸ See Kevin P. Block, *The Disciplining and Dismissal of Employees by Joint Ventures in the USSR*, 23 GEO. WASH. J. INT'L L. & ECON. 619, 627-38 (1990).

⁵¹⁹ See Christopher S. Clarke, Comment, *The Soviet Joint Venture Decree and Soviet Labor Law*, 30 VA. J. INT'L L. 761, 777-84 (1990).

⁵²⁰ See Afanasiev, *Termination of Labor Contracts*, East/West Exec. Guide, Dec. 1992, at 26 (source on file with the authors).

⁵²¹ See, e.g., Law on Collective Contracts and Agreements, Mar. 11, 1992, reprinted in ROS-SISKAYA GAZETA, Apr. 28, 1992 (source on file with the authors); see also Hendley, *Preliminary Framework for Labor Contracts*, COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. (source on file with the authors).

⁵²² Russian Foreign Investment Law, *supra* note 158, art. 34.

⁵²³ The Russian law was enacted following the U.S.S.R. Fundamentals of Legislation on Employment of January 15, 1991.

⁵²⁴ See Russian Foreign Investment Law, *supra* note 158, art. 34.

⁵²⁵ *Id.* art. 35.

securities of enterprises within the Russian Federation.⁵²⁶ Such securities may be purchased either with rubles, earned as profit in the Russian Federation, or foreign currency.⁵²⁷ Only the official exchange rate, however, may be utilized for purchases of stock or capital assets with foreign currency.⁵²⁸ Acquisitions of securities and assets by foreign entities and Russian enterprises with foreign investment are governed, *inter alia*, by the Russian Law on Currency Regulation⁵²⁹ and currency regulations issued by the Russian Ministry of Finance and the Russian Central Bank.⁵³⁰ Private security acquisitions are subject to registration with the Russian Ministry of Finance,⁵³¹ whereas public security acquisitions at the Russian stock exchanges are subject to the Russian Regulations on the Issuance and Distribution of Securities and Stock Exchanges.⁵³²

The Russian Company Law does not impose any specific transfer restrictions on the stock of open stock associations. For closed stock associations, however, article 7 of the Russian Company Law provides that the majority of shareholders must consent to the transfer unless the company's charter waives or modifies that requirement contractually. In addition, article 147 of the Russian Company Law contains special anti-trust restrictions on certain stock acquisitions: a market purchase of more than 15 percent of the outstanding shares of a stock association by one legal entity or natural person requires the consent of the Ministry of Finance; and a purchase of a controlling interest (more than 50 percent of the outstanding shares) in a stock association requires the consent of both the Ministry of Finance and the newly established R.S.F.S.R. Committee on Antimonopoly Policy and Support of New Economic Structures. Furthermore, in addition to the Russian Company Law, the R.S.F.S.R. Law on Competition and Restricting the Monopolistic Activity on Goods and Commodity Markets of March 22, 1991 contains specific guidelines, procedures, and policies on the matters of unfair competition affecting stock and asset acquisitions of Russian companies by foreign interests.

In light of the fact that the majority of Russian enterprises are still

⁵²⁶ *Id.* art. 3.

⁵²⁷ *Id.* art. 35.

⁵²⁸ *Id.* Presently, the official exchange rate is a market-determined rate. *See supra* notes 452–453 and accompanying text.

⁵²⁹ *See supra* text accompanying note 474.

⁵³⁰ *See supra* notes 460–464 and accompanying text.

⁵³¹ Russian Foreign Investment Law, *supra* note 158, art. 35.

⁵³² *See* Decree No. 78 on Regulations on the Issuance and Distribution of Securities and Stock Exchanges, Dec. 28, 1991 (source on file with the authors).

state-owned, purchasing equity interests, whether securities or assets, in such state enterprises requires that foreign investors comply with the complex requirements of the Russian privatization regime.⁵³³ Foreign firms are generally eligible to participate in the privatization of state and municipal enterprises by purchasing ownership interests in such enterprises in Russian currency subject to the regulations discussed above.⁵³⁴ The extent to which foreign investors may make security and asset acquisitions of the state-owned property is governed by the R.S.F.S.R. Law On Privatization of State-Run and Municipal Enterprises of July 5, 1991 (Russian Privatization Law),⁵³⁵ which has been supplemented by local and municipal legislation in all major Russian cities.⁵³⁶ Despite efforts to solicit the participation

⁵³³ It should be noted, however, that the private sector of the Russian economy is already significant. According to the official statistics, 15 percent of Russian GNP is produced by private business entities, which employ 20 million people. *See The Wild East*, *ECONOMIST*, Jan. 4, 1992, at 40.

⁵³⁴ Russian Foreign Investment Law, *supra* note 158, art. 37.

⁵³⁵ *See generally*, Russian Privatization Law, *supra* note 394; *see also* Russian Supreme Soviet Adopts Privatization Laws, *Foreign Broadcast Information System*, Foreign Broadcasts International Service-Soviet Union (FBIS-SOV), July 5, 1991, at 74 (source on file with the authors). The Russian law was adopted subsequent to the U.S.S.R. Law on Guidelines on Deregulation and Privatization of Enterprises.

⁵³⁶ *See, e.g.*, Decree No. 341 on Acceleration of the Privatization of State and Municipal Enterprises, Dec. 29, 1991; Decree on Ensuring Expedient Privatization of Municipal Property in the City of Moscow, Jan. 12, 1992; Decree of the R.S.F.S.R. Government On Several Questions Connected with the Privatization of the Housing Fund in the R.S.F.S.R., No. 67, Dec. 26, 1991; Decree of the President of the Russian Federation On Quickening the Privatization of State and Municipal Enterprises, Dec. 29, 1991; Decree of the President of the Russian Federation On the Guarantee of Expediting Privatization of Property in the City of Moscow, No. 16, Jan. 12, 1992; Decree of the President of the Russian Federation On Expediting the Privatization of State and Municipal Enterprises, No. 66, Jan. 29, 1992, including Appendix No. 1, Temporary Statute On the Procedure for Issuance, Formulation and Acceptance toward Examination of an Application for the Privatization of State and Municipal Enterprises in the Russian Federation; Appendix No. 2, Temporary Instructions Concerning the Appraisal of Cost of Objects for Privatization; Appendix No. 3, Temporary Statute On the Reorganization of State and Municipal Enterprises in Opening Auction Associations; Appendix No. 4, Temporary Statute On the Privatization of State and Municipal Enterprises in the Russian Federation at Auctions; Appendix No. 5, Temporary Statute On the Privatization of State and Municipal Enterprises in the Russian Federation through Competition; Appendix No. 6, Temporary Statute On the Procedure for Use in 1992 for the Privatization of Means of Funds of Economic Stimulation and Profit of State and Municipal Enterprises; Appendix No. 7, Temporary Statute On the Work of the Commission for Privatization; Decree of the Government of the Russian Federation On Accelerating the Implementation of the 1992 Privatization Program, No. 52, Jan. 29, 1992; Decree of the President of the Russian Federation On Additional Measures on Implementing the Guidelines of the Program of Privatization of State and Municipal Enterprises in the Russian Federation in 1992, No. 322, Apr. 2, 1992; Government Program for the Privatization of State and Municipal Enterprises in the Russian Federation in 1992, including five tables concerning indicators of privatization in certain areas and in certain industries and implementing decrees of the Supreme Soviet of the Russian Federation No. 2980-1, June 11, 1992. (All above sources on file with the authors.)

of foreigners in its privatization program, Russia has failed to attract significant foreign investment. This failure is due to the slow pace, cumbersome procedures, and inadequate infrastructure with which Russia has approached the task of transforming state enterprises into market-driven, self-sufficient business entities.

The Russian Privatization Law supplanted the pre-existing U.S.S.R. Law on Guidelines on Deregulation and Privatization of Enterprises (Soviet Privatization Law).⁵³⁷ Both acts agree on the following points: (1) they provide for an auction-like sale supervised by the local branches of the State Committee of Property on the basis of bids from the investors; (2) they allow the employees of the auctioned state companies to purchase their stock at a 30 percent discount; and (3) they prohibit legal entities from owning property or shares of state or municipal enterprises and organizations in excess of 25 percent of their charter capital.⁵³⁸ The Soviet Privatization Law provided for special priority rights to the workforce of the privatized companies and Soviet citizens, while the Russian Privatization Law accords all investors a more consistent treatment.⁵³⁹ The Soviet law also contemplated a buy-out privatization scenario, while the Russian law envisions a free transfer of certain state property to its citizens through monetary subsidies which may only be used to purchase privatized state property.⁵⁴⁰

Under former Soviet law, state-owned enterprises and organizations could convert themselves into the corporate form which brought special advantages and freed them from the limitations of the Law on State Enterprise.⁵⁴¹ Similarly, Soviet cooperatives could reorganize as limited liability companies to avoid the application of the Law on Cooperatives, which severely restricted the activities permitted to private cooperatives.⁵⁴² A state enterprise could form a

⁵³⁷ See Law of the U.S.S.R. on the Fundamental Principles of Destatization and Privatization of Enterprises, Vedemosti S.S.S.R., Aug. 7, 1991, translated in BUTLER, *supra* note 202, at 79 [hereinafter Soviet Privatization Law].

⁵³⁸ See Holland, *The Russian Republic Law on Privatization*, E. Eur. Rep. (BNA) No. 2, at 88 (Nov. 11, 1991), available in LEXIS, BNA Library, EERPT File; see also Grabovsky & Viktorov, *Getting Down to Business*, KOMMERSANT, July 8, 1991, at 3.

⁵³⁹ See generally Kaj Hober, *The New October Revolution: Launching the Russian Privatization Program*, 3 COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. 6-8 (1992) (source on file with the authors); Kavass, *Nature and Problems of Privatization*, 3 COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. 1 (1992) (source on file with the authors); see Dean & Barale, *A Primer on Privatization*, A.B.A. J., Supplement to Nov. 1992 issue, at 19.

⁵⁴⁰ See *Russian Voucher Plan Detailed; Foreign Participation Invited*, 9 Int'l Trade Rep. (BNA) 1508 (Aug. 26, 1992), available in LEXIS, BNA Library, Intrad File.

⁵⁴¹ See generally Olga Floroff & Susan Tiefenbrun, *A Legal Framework for Soviet Privatization*, 18 PEPPERDINE L. REV. 849 (1991).

⁵⁴² *Id.*

joint-stock association only with the approval of both its work collective and the state agency responsible for overseeing the privatization process of such an enterprise.⁵⁴³ Shares would then be issued corresponding to the full value of the property of the state enterprise, with proceeds of the issue credited to the state budget.⁵⁴⁴ In the event of an undersubscribed stock issue, ownership of the state enterprise's shares would vest in the U.S.S.R. State Property Fund.⁵⁴⁵ This new state agency, charged with the privatization of state-owned companies and other state assets, was similar in function to the State Property Agency in Hungary or Treuhand in East Germany.⁵⁴⁶

Among former Soviet republics, the privatization process has been most advanced in the Russian Federation, where the R.S.F.S.R. State Committee to Manage State Property and the Russian Republican Property Fund, created under corresponding legislation, have begun operations.⁵⁴⁷ These laws contain general provisions dealing with the registration of new companies which evolved from previously state-owned enterprises, and the conversion of such enterprises into stock associations.⁵⁴⁸ Larger cities, such as Moscow and St. Petersburg, have also announced their own, even more ambitious plans to privatize their municipal property.⁵⁴⁹

On December 29, 1991, President Yeltsin issued another executive decree ordering a large-scale privatization of formerly state-owned enterprises in the light industrial and service sectors of the Russian economy.⁵⁵⁰ Certain other businesses, such as pharmaceutical plants, tobacco and alcohol factories, certain construction companies, and educational organizations will be privatized specifically by decree.⁵⁵¹ In addition, municipal property, including power companies, communications, and mass transit, will be privatized directly by the cities.⁵⁵² The state will relinquish ownership of up to 70 percent of

⁵⁴³ *Id.*

⁵⁴⁴ *Id.*

⁵⁴⁵ *Id.*

⁵⁴⁶ *Id.*

⁵⁴⁷ See Regulations on the Russian Federal Property Fund, July 3, 1991; Law on Inscribed Privatization Accounts and Deposits in the R.S.F.S.R., July 3, 1991 (source on file with the authors).

⁵⁴⁸ See March & Pistor *Legal Aspects of privatization in Russia* (private memorandum issued by the law firm of Cole, Corette & Abrutyn, Washington, D.C.), at 5 (source on file with the authors).

⁵⁴⁹ *Id.*

⁵⁵⁰ See *Major Industries to Privatize Light Industry, Services Begins*, 2 E. Eur. Rep. (BNA) No. 1 (source on file with the authors).

⁵⁵¹ See *Russian Privatization Plan Divides Industries by Degree of Approval Required*, SOVIET BUS. L. REP., Jan. 27, 1992, at 7, available in LEXIS, Nexis Library, RCBLR File.

⁵⁵² *Id.*

all enterprises in those sectors (estimated at R92 billion or about \$1 billion at the present exchange rate). Foreign investors will be invited to participate in the privatization process and will be given the buy-out rights along with Russian companies, organizations, and individuals. Yet another Yeltsin decree abolished collective farming and allowed private farming and private ownership of farm lands.⁵⁵³ Enactment of a number of new laws and regulations have further solidified and advanced Russian privatization efforts throughout 1992, although most of the actual sales of state-owned enterprises and property have not taken place in 1992 and are expected to take place between 1993 and 1995.⁵⁵⁴

k. *Investment Protection and Guarantees*

Foreign investors in the Russian Federation enjoy full and absolute legal protection and national treatment.⁵⁵⁵ Thus, opportunities for foreign investment should be comparable to those opportunities afforded to Russian investors.⁵⁵⁶ Indeed, judging by standards of international law, the Russian law, as well as the former Soviet Foreign Investment Law, contains rather strong investor protection language.⁵⁵⁷ Foreign investors are also guaranteed that their invest-

⁵⁵³ See *Russian Agricultural Reform Decree Allows Citizens to Buy, Sell Land*, 2 E. Eur. Rep. (BNA) No. 2, at 43, (Jan. 20, 1992), available in LEXIS, BNA Library, EERPT File.

⁵⁵⁴ See Sirodova & Hagler, *Russian Privatization Rules in State of Change*, Doing Business in Eastern Europe (CCH) 125 (July 21, 1992).

⁵⁵⁵ Russian Foreign Investment Law, *supra* note 158, art. 6. In addition, the Russian Federation has entered into a bilateral investment protection agreement with the United States, the Treaty Between the United States of America and the Russian Federation Concerning the Encouragement and Reciprocal Protection of Investment, signed by Presidents Bush and Yeltsin on June 17, 1992. See U.S.-Russia Investment Treaty, *supra* note 395, at 9, available in LEXIS, Nexis Library, RCBLR File. The treaty was ratified by the U.S. Senate and Russian Parliament and has entered into effect for the term of ten years. The treaty provides a number of intergovernmental and private civil remedies and guarantees for the protection of U.S. investment in Russia. See *U.S.-Russia Investment Treaty Moves Forward; Progress Seen on Ruble, Profits Repatriation Issue*, RUSSIA & COMMONWEALTH BUS. L. REP., Aug. 10, 1992, at 4, available in LEXIS, Nexis Library, RCBLR File.

⁵⁵⁶ Russian investors, however, may be granted some special privileges under the Russian Foreign Investment Law. See Russian Foreign Investment Law, *supra* note 158, art. 6. The Russian Foreign Investment Law and the U.S.-Russia Investment Treaty specifically reserve the right for the Russian government to exclude foreign investors from certain sectors of the Russian economy. See William G. Frenkel, *Republics of the C.I.S. Join the U.S. Trade and Investment Treaty Program*, 3 COLUM. PARKER SCH. SOV. & E. EUR. L. BULL. 6-7 (Aug./Sept. 1992) (source on file with the authors).

⁵⁵⁷ The Soviet version additionally contained a grandfather clause that protected any enterprise with foreign investment from worsened foreign investment legal conditions for ten years (during which period Soviet and republican law as of the time of creation of the enterprise

ments will not be nationalized, requisitioned (expropriated), or confiscated except as required in special circumstances to promote public interest.⁵⁵⁸ In the case of such public taking, the foreign investor must be quickly and adequately compensated.⁵⁵⁹ Any unlawful official action against a foreign investor may be appealed to the Russian courts, and the foreign investor may seek consequential and/or special damages.⁵⁶⁰ Moreover, compensation for losses to foreign investors must be paid in the currency in which the investment was made, and in the amount of loss suffered on the date the nationalization decision was officially announced.⁵⁶¹ Until such compensation is made, interest will accrue at the interest rate prevailing in the Russian Republic.⁵⁶²

1. *Repatriation and Reinvestment of Profits*

Foreign investors are guaranteed the right to transfer abroad all amounts legally received in foreign currency in Russia, including profit derived from investments, contractual amounts due to them, amounts generated through liquidation of investments, and compensation amounts.⁵⁶³ Foreign investors must make required tax and other withholdings before transferring the funds.⁵⁶⁴ The above amounts may also be reinvested in Russia in accordance with Russian law.⁵⁶⁵ For repatriation purposes, foreign investors may purchase foreign currency on the internal currency market pursuant to the Russian currency regulations⁵⁶⁶ at the prevailing official exchange rate, which is currently market-based.⁵⁶⁷ In addition, under the Russian Foreign Investment Law, a special arrangement is possible

would apply). See Soviet Foreign Investment Law, *supra* note 222, art. 9. This grandfather clause was not to be relied on in the cases of legislative changes in taxation, finance, environmental, criminal or anti-trust law. *Id.*

⁵⁵⁸ Russian Foreign Investment Law, *supra* note 158, art. 7.

⁵⁵⁹ *Id.* art. 8.

⁵⁶⁰ See *id.*

⁵⁶¹ *Id.*

⁵⁶² *Id.* art. 8.

⁵⁶³ *Id.* art. 10; see also U.S.-Russia Investment Treaty, *supra* note 395, art. IV (addressing guarantees of U.S. investors' transfers of funds from Russia).

⁵⁶⁴ Russian Foreign Investment Law, *supra* note 158, art. 10.

⁵⁶⁵ *Id.* art. 11.

⁵⁶⁶ See *Foreign Investors in Russia to Change Dollars at Market Rate*, 58 Banking Rep. (BNA) No. 19, at 851 (May 11, 1992) (source on file with the authors).

⁵⁶⁷ Russian Foreign Investment Law, *supra* note 158, art. 11.

whereby foreign investors with special permission of the R.S.F.S.R. Ministry for Foreign Economic Relations may use a mutually set exchange rate no higher than the official rate to repatriate their ruble profits abroad in convertible currency.⁵⁶⁸ This special arrangement exists for entities with foreign investment which manufacture products of vital national significance with import-substitution purposes, as confirmed by the R.S.F.S.R. Ministry for External Economic Affairs.⁵⁶⁹

Foreign investors should be cognizant, however, of the requirement under the Russian Foreign Investment Law that all expenditures in foreign currency, including transfer of dividends abroad, be made from the funds in foreign currency earned by the enterprise or legally obtained in the Soviet Union.⁵⁷⁰ The precise scope of this provision is not clear but it should be interpreted to mean that a foreign investor must be able to prove that the funds in convertible currency to be repatriated have been obtained in the ordinary course of its business activity in Russia and in full compliance with Russian law, including currency exchange controls. Interestingly, this convertible currency self-sufficiency rule was conspicuously absent from the all-Union laws on foreign investment, whereas the hard currency self-sufficiency rule was a fundamental principle under the old Joint Venture Law.⁵⁷¹ Previously, for repatriation purposes, foreign investors who earned Soviet currency from their U.S.S.R. operations could also purchase foreign currency on the internal currency market at the prevailing exchange rate pursuant to the U.S.S.R. Law on Currency Regulation and regulations promulgated thereunder.⁵⁷² This single most important change in the Soviet currency regime was expected to allow joint ventures which did not produce for export and consequently lacked foreign currency revenue, to repatriate funds in convertible currency to their

⁵⁶⁸ *Id.*

⁵⁶⁹ *Id.*

⁵⁷⁰ *See id.* art. 26.

⁵⁷¹ *Id.* cf. Decree No. 49, *supra* note 3, art. 25 ("All currency expenditures of a joint enterprise, including the payment of profit and other amounts due foreign participants and specialists, must be ensured by the joint enterprise from receipts from the realization of its products on the foreign market.").

⁵⁷² *See* Law of the U.S.S.R. on Currency Regulation, Vedomosti S.S.S.R., Mar. 1, 1991, No. 12, 316, art. 11, *translated in* BUTLER, *supra* note 42, at 341 [hereinafter Soviet Currency Law]; *see also* Roswell B. Perkins & Jonathan H. Hines, *Soviets Change Currency Rules*, 10 INT'L FIN. L. REV. 22; Frenkel et al., *supra* note 458, at 306.

foreign investors.⁵⁷³ In practice, though, the availability of hard currencies at such auctions has been severely limited.⁵⁷⁴ The Soviet interbank currency market was never fully implemented and funded so that banks could begin exchanging currencies without substantial limitations.⁵⁷⁵ In 1991, the Soviet hard currency reserves had been depleted to the extent that the country was having difficulties repaying its foreign debts.⁵⁷⁶

The situation in 1992 was not very different in the Russian Federation where the hard currency deficit continued to be acute.⁵⁷⁷ Thus, as in the past, export orientation has been crucial to the feasibility of most joint ventures and other foreign-owned companies operating in the U.S.S.R. and remains very important to foreign investors in Russia and other former Soviet republics today. Following the major tenets of the former Soviet Law on Currency Regulation, the new Russian currency regime emphasizes the need to ration convertible currency for transfers abroad and to limit the right to repatriate profits to enterprises with foreign investment.⁵⁷⁸ The internal hard currency market in Russia, however, is operating and is relatively accessible to enterprises with foreign investment wishing to convert limited amounts of their ruble earnings into foreign currencies at the unfavorable (for the party selling rubles) market rate.⁵⁷⁹

⁵⁷³ See Bill Keller, *Soviets to Let West Convert Ruble Profits*, N.Y. TIMES, Oct. 30, 1990, at D1.

⁵⁷⁴ See Felker, *supra* note 10, at 237-39. Apart from hard currency auctions, the other methods for generating convertible currency for the purposes of repatriating profits made in the Soviet Union included export sales, sales to Soviet entities for hard currency, import substitution techniques, countertrade, and compensation transactions. *Id.* at 222-23.

⁵⁷⁵ *Id.*; see U.S.S.R. Presidential Decree on the Introduction of the Commercial Exchange Rate Between the Ruble and Foreign Currencies and on the Measures of the Creation of a Nationwide Currency Market of October 26, 1990, *reprinted in* Foreign Broadcast Information System, National Affairs, FBIS-SOV-90-209 (Oct. 29, 1990) (source on file with the authors).

⁵⁷⁶ See Wertman, *The International Reserve Position of the Former Soviet Republics: Is the "Cupboard" Bare?*, in Congressional Research Service (CRS) Report for U.S. Congress, Apr. 10, 1992 (source on file with the authors); see also *Rouble Trouble: Stepping Out*, ECONOMIST, Jan. 14, 1989, at 62.

⁵⁷⁷ See Goldman, *Post-Soviet Transformation*, Congressional Research Service Issue Brief, Mar. 17, 1992, at CRS-7 (source on file with the authors).

⁵⁷⁸ One way the new Russian currency regime limits access to the interbank currency exchange is by only allowing resident companies to convert rubles into convertible currencies. There are also logistical limitations on the amounts of rubles that can be converted and availability of funds in foreign currency at the participating Russian banks. See Frenkel, *supra* note 474, at 5.

⁵⁷⁹ See ERNST & YOUNG, EAST EUROPEAN COUNTRY PROFILES: RUSSIA 5 (May 1992).

m. *Dispute Resolution*

Parties to disputes concerning foreign investment in the Russian Federation must submit their claims to the Russian Supreme Court or the Russian Supreme Court of Arbitration, unless an international treaty in force on the Russian territory provides for a different arbitration forum.⁵⁸⁰ The appropriate Russian court or administrative agency must hear disputes between individual foreign investors, enterprises with foreign investment, other Russian enterprises, and Russian governmental bodies.⁵⁸¹ If the parties agree, such disputes may also be heard by various arbitral bodies, both domestic and foreign.⁵⁸²

n. *Free Economic Zones*

The law contemplates the creation of special "free economic" trade zones which accommodate foreign investment on more beneficial terms.⁵⁸³ These terms may include simplified registration procedures, tax breaks, low-rent, long-term leases of land and natural resources, special customs exemptions, and a simplified visa regime.⁵⁸⁴ The R.S.F.S.R. Council of Ministers must determine, and the R.S.F.S.R. Supreme Soviet must approve, the benefits to be accorded enterprises with foreign investment.⁵⁸⁵

⁵⁸⁰ Russian Foreign Investment Law, *supra* note 158, art. 9. The U.S.-Russia Bilateral Investment Protection Treaty also provides a number of special arbitration provisions available to a U.S. investor in the Russian Federation. See U.S.-Russia Investment Treaty, *supra* note 395, arts. V-VIII.

⁵⁸¹ Russian Foreign Investment Law, *supra* note 158, art. 9.

⁵⁸² *Id.* This provision permits parties to an investment agreement to select a forum and procedure for arbitral proceedings different from the ones suggested by the Russian Foreign Investment Law. The choice of institutional or ad hoc arbitration outside Russia is wide and extends to various international centers of arbitration in western Europe and the United States. See generally Jonathan H. Hines, *Dispute Resolution and Choice of Law in U.S.-Soviet Trade*, in A NEW LOOK AT DOING BUSINESS WITH THE SOVIET UNION 1989 125 (Eugene Theroux ed., 1989).

⁵⁸³ Russian Foreign Investment Law, *supra* note 158, art. 41.

⁵⁸⁴ See *id.* art. 42.

⁵⁸⁵ See *id.*; On the Creation of Free Enterprise Zones, Vedomosti R.S.F.S.R., July 14, 1990, as amended by On the Creation of Free Entrepreneurship Zones, Vedomosti R.S.F.S.R., Sept. 13, 1990, translated in BUTLER, *supra* note 390, at 289, 291; see, e.g., On Priority Measures Relating to the Development of the Free Entrepreneurship Zone of the City of Leningrad (LFEZ) E.P. R.S.F.S.R., June 11, 1991, No. 328, translated in BUTLER, *supra* note 390, at 393; Decree on the Creation of Free Economic Zone in the City of Nakhodka of Primorsky Krai, Nov. 23, 1990.

IV. FOREIGN INVESTMENT LAWS OF OTHER FORMERLY SOVIET REPUBLICS

Following the Russian Republic's lead, most other former Soviet republics have enacted their own foreign investment legislation. Throughout 1991, Ukraine, Belarus and Kazakhstan (constituting the three largest C.I.S. republics after Russia) and the Baltic states of Lithuania, Latvia, and Estonia passed such laws. Moldova, Armenia, Azerbaijan, and the Central Asian republics of Uzbekistan, Tajikistan, and Kirghizstan have also recently adopted foreign investment laws, but their domestic legal systems have not yet matured to the point of other C.I.S. republics. Overall, because these laws have been modeled on the Russian and Soviet versions, many similarities may be noted. For instance, all of the above laws contain provisions on national treatment of foreign investors, guarantees against expropriation, registration of enterprises with foreign investment, repatriation of profits, special tax and customs incentives, and international arbitration. Certain differences summarized below, however, make the laws of these republics less amenable to a critical legal analysis and reliance. Generally, these laws are shorter and less detailed than the Russian law and arguably offer less certainty in the legal protection of foreign investment. This is, of course, a reflection of these republics' lesser developed legal systems, in which the transition of private civil law to market relations and freedom of contract has not been as rapid and systematic as in Russia. Generally, a sophisticated and comprehensive foreign investment regime, without major investment incentives, would probably be considered more attractive to many western investors than a less sophisticated and stable regime with generous investment incentives.

On the other hand, all of the former Soviet republics recognize the importance of western capital and technology and have begun to compete against each other for foreign investment.⁵⁸⁶ Consequently, a more simplistic drafting characteristic of most of the republican laws and some of their loopholes may be successfully

⁵⁸⁶ See *Russia Scores High; Armenia, Moldova Flunk*, USA TODAY, Aug. 17, 1992, at 3B (containing results of a survey conducted by the Geonomics Institute of Middlebury, VT, grading each of the fifteen former Soviet republics on their business potential for U.S. investors and companies). In the Geonomics Report, Russia received the highest score overall of "A-" along with Estonia and Latvia while Belarus and Ukraine received "B+" and Kazakhstan received "B." *Id.*

exploited to the foreign investor's advantage.⁵⁸⁷ Moreover, some of these republics offer substantial advantages to the foreign investor in the areas of tax incentives, foreign exchange, and other significant legal and operational benefits.⁵⁸⁸ These advantages should be considered in the comparative analysis of the foreign investment regimes of the former Soviet republics.

A. *Ukraine*

Ukraine, the second largest republic of the former U.S.S.R. with important industrial and agricultural interests, has, until recently, lacked a comprehensive foreign investment law.⁵⁸⁹ Ukraine first authorized direct foreign investment by decree.⁵⁹⁰ On September 10, 1991, the Ukrainian government adopted the Law on Protection of Foreign Investments.⁵⁹¹ This law guarantees foreign investors the right to repatriate profits in rubles or in foreign currencies, or to reinvest such profits in the Ukraine.⁵⁹² The law also prohibits expropriation of foreign investments and provides for compensation in cases of public takings.⁵⁹³ Furthermore, the law requires the government to promulgate a list of foreign investment activities that will require licensing and licensing procedures.⁵⁹⁴

Subsequently, the Ukrainian parliament adopted the Law on Foreign Investments of March 11, 1992 (Ukrainian Law on Foreign

⁵⁸⁷ See, e.g., Christopher Osakwe, *The Death of Ideology in Soviet Foreign Investment Policy: A Clinical Examination of the Soviet Joint Venture Law of 1987*, 22 VAND. J. TRANSNAT'L L. 1, 96-100 (1989) (demonstrating how the former Soviet joint venture regime could be manipulated by the foreign investor to its advantage due to the poor legislative drafting).

⁵⁸⁸ See Focus: Eastern Europe, No. 54, Aug. 25, 1992 (available from Deutsche Bank Research) (comparing the foreign investment regimes of Kazakhstan, Ukraine and Belarus).

⁵⁸⁹ See *Ukrainian Laws Recently Passed*, SOVIET BUS. L. REP., Dec. 13, 1991, available in LEXIS, Nexis Library, RCBLR File.

⁵⁹⁰ See Decree on Foreign Economic Activities, Apr. 16, 1991 (source on file with the authors); see also Law on Investment Activity, Sept. 18, 1991; see generally *Ukraine Trails Russia in Legal Reforms; Has Potential for Economic Strength*, E. Eur. Rep. (BNA) No. 5, at 239-41 (Dec. 23, 1991), available in LEXIS, BNA Library, EERPT File. The Decree outlined in broad terms the regulatory structure for administering foreign investments. Details concerning the establishment and operation of companies with foreign investment were left to be filled by the subsequent enacting laws and regulations. *Id.*

⁵⁹¹ For the English translation of the law, see 1 RUSSIA AND THE REPUBLICS: LEGAL MATERIALS 1 (Hazard & Pechota, eds.) [hereinafter *Ukrainian Law on Protection of Foreign Investments*] (source on file with the authors).

⁵⁹² *Ukrainian Law on Protection of Foreign Investments*, *supra* note 591, arts. 4, 5.

⁵⁹³ *Id.* art. 3.

⁵⁹⁴ *Id.* art. 7.

Investments), which complements the prior Law on Foreign Economic Activity and the Law on Investment Activities and supplies the previously missing detail.⁵⁹⁵ The new law entered into force on April 1, 1992 and offers foreign investors substantial incentives and investment protection guarantees.⁵⁹⁶ It also provides the regulatory framework for registering and implementing investments in the Ukrainian economy by foreign companies and individuals.⁵⁹⁷ Compared to the foreign investment laws of other ex-Soviet republics, the Ukrainian Foreign Investment Law certainly appears to provide one of the most generous packages of incentives and a relatively stable legal environment for foreign investors. This law can be favorably compared to the Russian Foreign Investment Law. Significant disadvantages for foreign investors in Ukraine, however, pertain to the slow pace of privatization, the uncertainty surrounding the introduction and stability of the Ukrainian national currency, the hryvnia, and the implementation of further legal reforms in Ukrainian private civil law.⁵⁹⁸

The above enactments comprise a fairly cohesive legal structure for encouraging and regulating foreign investment in Ukraine. The overall investment climate in Ukraine, however, remains somewhat unclear. The Ukrainian private civil law, which is still in developmental stages, is generally inadequate. For example, there is a lack of clarity with respect to issues of land ownership, and there are unresolved questions of whether and on what terms the Ukrainian national currency will be introduced later this year.

Similar to the Russian foreign investment law on which it appears to be modeled, the new Ukrainian Foreign Investment Law specifically permits all forms of foreign investment in its domestic economy, such as: (i) forming new companies or enterprises; (ii) acquiring stock of existing Ukrainian enterprises and companies; (iii) acquiring various personal and real property, property rights, and securities; and (iv) all other forms of investment not otherwise

⁵⁹⁵ See Law on Foreign Investments, Mar. 11, 1992, translated in *Text of Ukrainian 'Law on Foreign Investments'*, RUSSIA & COMMONWEALTH BUS. L. REP., May 29, 1992, available in LEXIS, Nexis Library, RCBLR File [hereinafter *Ukrainian Foreign Investment Law*]; see also *Ukrainian Foreign Investment Law Creates Attractive Environment for investors*, RUSSIA & COMMONWEALTH BUS. L. REP., May 29, 1992, at 3, available in LEXIS, Nexis Library, RCBLR File.

⁵⁹⁶ See generally *Ukrainian Foreign Investment Law*, *supra* note 595.

⁵⁹⁷ *Id.*

⁵⁹⁸ See generally Matthew S.R. Palmer, *Privatization in Ukraine: Economics, Law and Politics*, 16 YALE J. INT'L L. 453 (1991).

forbidden by Ukrainian law.⁵⁹⁹ Thus, the foreign investor in Ukraine interested in making a capital or active investment has the choice of creating wholly-owned subsidiaries or joint venture companies with Ukrainian partners, or acquiring full or partial stock ownership of Ukrainian companies.⁶⁰⁰ Furthermore, passive investments in Ukrainian assets and property are allowed.⁶⁰¹ The law provides that foreign investors will be allowed to participate in the privatization of state and municipal enterprises and property pursuant to privatization legislation forthcoming.⁶⁰²

The law also contains a definition of an "enterprise with foreign investment," which includes any entity which has foreign ownership on average during the calendar year of either; (a) 20 percent of its authorized charter fund, or (b) an equity interest of at least \$100,000.⁶⁰³ Identical standards apply to passive investments.⁶⁰⁴ Ruble investments, including cash denominated in the former Soviet rubles, ruble payment documents and securities, and in-kind contributions by the nationals of the former U.S.S.R. made by persons from other states, including the republics of the C.I.S., generally are not deemed foreign investments and are governed by a different enactment, the Law on Investment Activity.

A relatively simple and streamlined procedure exists for registering enterprises with foreign investments in the Ukraine.⁶⁰⁵ The enterprise should submit a completed application form to the Ministry of Finance, which is supposed to act on it in three working days.⁶⁰⁶ The Ministry may deny registration solely on the grounds of non-compliance with legal requirements, and the enterprise may appeal the denial to a court of law.⁶⁰⁷ Furthermore, enterprises proposing to conduct insurance and financial intermediary activities must obtain permission from the Ministry of Finance, and those enterprises proposing to engage in banking activities must obtain a license from the National Bank of Ukraine.⁶⁰⁸

⁵⁹⁹ Ukrainian Foreign Investment Law, *supra* note 595, art. 4.

⁶⁰⁰ See *id.* arts. 39–41; see also *Ukraine's Foreign Investment Law Contains Important New Rules*, Doing Business in Eastern Europe (CCH) 1–2 (May 1992).

⁶⁰¹ See Ukrainian Foreign Investment Law, *supra* note 595, arts. 3–4.

⁶⁰² *Id.* art. 41.

⁶⁰³ Ukrainian Foreign Investment Law, *supra* note 595, arts. 1, 2.

⁶⁰⁴ *Id.*

⁶⁰⁵ See Ukrainian Foreign Investment Law, *supra* note 595, arts. 15–19.

⁶⁰⁶ *Id.* arts. 15–16.

⁶⁰⁷ *Id.* art. 17.

⁶⁰⁸ *Id.* art. 24.

Enterprises with foreign investment are exempted from export/import licensing requirements with respect to their own production and imports for their own needs.⁶⁰⁹ Subject to certain limitations, capital contributions of foreign investors, other property imported for investment, and property of foreign employees are exempt from customs duties and import taxes.⁶¹⁰ Yet finished goods, raw materials and certain other items imported by enterprises with foreign investment for their own needs are exempted from import taxes only.⁶¹¹

The revenue of enterprises with foreign investment in convertible currency may be retained by such enterprises and is not subject to any withholding or forced exchange.⁶¹² The valuation of a foreign investor's capital contributions may be carried out, at its discretion, in foreign currency or in Ukrainian currency.⁶¹³ Moreover, in-kind contributions are to be valued by the parties on the basis of world market prices.⁶¹⁴ The exchange rate for cash contributions may be negotiated contractually but may not be lower than the official exchange rate set by the National Bank of Ukraine.⁶¹⁵

Foreign investors are permitted to securitize their property through pledges and mortgages.⁶¹⁶ No specific Ukrainian law on secured transactions existed until recently, however, to address the procedures for registering and enforcing security interests. The Ukrainian foreign investment law also provides for the development, extraction, and exploitation of natural resources on the basis of long-term concession agreements.⁶¹⁷ The term of such concession agreements may not exceed 99 years.⁶¹⁸ The law also purports to allow foreign ownership of rights in land and natural resources.⁶¹⁹ The scope of such ownership rights is unclear and is expected to be clarified by the Ukrainian Land Code soon to be passed.⁶²⁰ Furthermore, the law contains provisions on intellectual property governing

⁶⁰⁹ Ukrainian Foreign Investment Law, *supra* note 595, art. 29.

⁶¹⁰ *Id.* art. 28.

⁶¹¹ *Id.*

⁶¹² *Id.* art. 29.

⁶¹³ Ukrainian Foreign Investment Law, *supra* note 595, art. 5.

⁶¹⁴ *Id.*

⁶¹⁵ *Id.*

⁶¹⁶ *Id.* art. 34.

⁶¹⁷ Ukrainian Foreign Investment Law, *supra* note 595, arts. 42, 44.

⁶¹⁸ *Id.* art. 44.

⁶¹⁹ *See id.* art. 42.

⁶²⁰ *See Foreign Investment Differences in Ex-USSR*, BUSINESS EASTERN EUROPE, July 6, 1992, at 321-22, available in LEXIS, Europe Library, Bueeur File.

the relations between enterprises with foreign investment and their employees.⁶²¹ With regard to labor relations, the law establishes a general principle that employees of enterprises with foreign investment may not be subject to a contractual regime which is less favorable than the Ukrainian labor legislation.⁶²² These enterprises, therefore, may be required to enter into collective bargaining agreements with the local labor unions.⁶²³ Foreign employees are not subject to Ukrainian labor law.

The law also provides special tax incentives to joint venture companies with local and foreign participants, which amount to perhaps the most generous tax regime for foreign investors in the C.I.S..⁶²⁴ Foreign investors in Ukrainian joint ventures qualify for a five-year tax holiday and a subsequent 50 percent reduction in the tax rate.⁶²⁵ There is no minimum share ownership requirement for the Ukrainian partner in the joint venture.⁶²⁶ The term of this tax holiday for wholesale and retail trade enterprises is three years, and that for enterprises engaged in intermediary activities is two years.⁶²⁷ After the expiration of the initial term of the tax holiday, such enterprises pay taxes in the amount of 70 percent of the regular rates.⁶²⁸ Furthermore, their goods and services are exempt from the value-added tax for five years.⁶²⁹

Wholly foreign owned entities, on the other hand, are only entitled to deductions of capital investment expenditures from their gross taxable income.⁶³⁰ Enterprises with foreign investments may also deduct from their taxable income any amounts reinvested in the Ukrainian economy.⁶³¹ Moreover, profits and dividends repatriated by enterprises with foreign investment abroad are subject to the 15 percent withholding tax.⁶³²

Additionally, the Ukrainian Foreign Investment Law grants for-

⁶²¹ Ukrainian Foreign Investment Law, *supra* note 595, art. 35.

⁶²² *Id.* art. 36.

⁶²³ *See id.*

⁶²⁴ For a comparison of the tax rate structures in various C.I.S. republics, see Guzel Anulova, *Foreign Investors' Tax Preferences in Ex-USSR*, BUSINESS EASTERN EUROPE, July 13, 1992, at 338, available in LEXIS, Europe Library, Bueeur File.

⁶²⁵ Ukrainian Foreign Investment Law, *supra* note 595, art. 32.

⁶²⁶ *See id.*

⁶²⁷ *Id.*

⁶²⁸ *Id.*

⁶²⁹ *Id.*

⁶³⁰ *Id.*

⁶³¹ *Id.*

⁶³² *Id.*

eign investors a host of investment guarantees.⁶³³ These guarantees include the following: a guarantee against adverse legislative changes in the foreign investment regime for a period of 10 years after the registration date; a guarantee of national treatment (with some reservations); a guarantee against expropriation or nationalization without adequate, effective, and prompt compensation to the foreign investor; a guarantee of the right to transfer abroad income, profits and dividends, and the principal amount or proceeds of any terminated or aborted foreign investment in the Ukraine; and the guaranty, subject to certain conditions, of the right of foreign investors to use Ukrainian currency to acquire convertible currency or to purchase products on the Ukrainian market for subsequent export.⁶³⁴

B. *Belarus*

The republic of Belarus (formerly Byelorussia), the third Slavic ex-Soviet republic bordering Russia and Ukraine, enacted its own foreign investment law on November 5, 1991 (Belarussian Foreign Investment Law).⁶³⁵ The law is similar to the former all-Union Soviet Foreign Investment Law⁶³⁶ and allows foreign interests to acquire up to 100 percent of Belarus enterprises and property, including real estate.⁶³⁷ Foreign investment in Belarus can take a number of structural forms, including joint venture companies, wholly-owned subsidiaries, or the acquisition of assets, securities, or intangible property rights.⁶³⁸ Although similar to the Ukrainian law which contemplates investment in land, the law specifically authorizes investment in Belarussian real estate and land ownership by private entities.⁶³⁹ Both domestic and foreign land ownership, however, is still fraught with uncertainty.⁶⁴⁰ Special benefits are afforded entities

⁶³³ See, e.g., *Id.* art. 8.

⁶³⁴ *Id.* arts. 8–14.

⁶³⁵ See Law on Foreign Investments, Nov. 14, 1991, in *LEGAL AND PRACTICAL ASPECTS OF DOING BUSINESS IN THE SOVIET REPUBLICS*, (PLI Handbook Series No. 604, 1992) [hereinafter *Belarussian Foreign Investment Law*]; Law on Fundamentals of Foreign Economic Activity, Jan. 1, 1991 (source on file with the authors); see also *Byelorussia Adopts Law Governing Foreign Investment, Minister Says*, E. Eur. Rep. (BNA) No. 3, at 106 (Nov. 25, 1991), available in LEXIS, BNA Library, EERPT File; Alan B. Sherr, *Republic of Belarus: Current Opportunities for Investment*, 2 East/West Exec. Guide, May 1992, at 19 (source on file with the authors).

⁶³⁶ See *supra* note 222 and accompanying text.

⁶³⁷ Belarussian Foreign Investment Law, *supra* note 635, arts. 2, 6.

⁶³⁸ *Id.* art. 4.

⁶³⁹ *Id.*

⁶⁴⁰ *Id.* art. 27; see also *Foreign Investment Differences in Ex-USSR*, BUSINESS EASTERN EUROPE, July 6, 1992, at 322, available in LEXIS, Europe Library, Bueeur File.

with at least 30 percent foreign capital.⁶⁴¹ For example, these entities are exempt from licenses required of Belarussian entities to conduct foreign trade, from mandatory buy-back of foreign currency earned from exports, and are granted a three-year tax holiday, with a possible additional three-year 50 percent exemption upon authorization of the Council of Ministers.⁶⁴² Joint venture companies with a foreign capital share exceeding 30 percent are exempt from the forced buy-back of foreign currency proceeds generated from export sales of their own products.⁶⁴³ Under a retention quota system, however, Belarussian enterprises with foreign capital are obligated to pay hard-currency tax on their export earnings amounting to 30 to 75 percent.⁶⁴⁴

The law also requires a discretionary administrative approval from the Council of Ministers for an entity with foreign participation exceeding R30 million.⁶⁴⁵ Otherwise, the local Soviets of People's Deputies reviews the application for the creation of an enterprise with foreign investment and the supporting documentation submitted by the entity's founders.⁶⁴⁶ In order to maintain effective registration, the foreign participant in the Belarussian enterprise must contribute at least 50 percent of its subscription to the authorized charter capital within one year from the date of registration.⁶⁴⁷ Belarussian law permits only domestic enterprises to engage in certain business activities; the law permits enterprises with foreign investment to engage in other activities only upon receipt of a license.⁶⁴⁸ A grandfather clause protects foreign investors from an adverse change in Belarussian law for five years after the change, provided the company has registered prior to such legislative change.⁶⁴⁹

C. *Kazakhstan*

Kazakhstan is an important ex-Soviet Central Asian republic which shares a common border with the Russian Federation and is rich in

⁶⁴¹ See Belarussian Foreign Investment Law, *supra* note 635, arts. 15–31.

⁶⁴² *Id.* arts. 15, 17, 22, 30–31.

⁶⁴³ *Id.* art. 17.

⁶⁴⁴ See Guzel Anulova, *Foreign Exchange Rules in the Former USSR*, BUSINESS EASTERN EUROPE, July 20, 1992, at 350, available in LEXIS, Europe Library, Bueeur File.

⁶⁴⁵ Belarussian Foreign Investment Law, *supra* note 635, art. 7.

⁶⁴⁶ *Id.* art. 9.

⁶⁴⁷ *Id.* art. 14.

⁶⁴⁸ *Id.* arts. 5, 12.

⁶⁴⁹ *Id.* art. 34.

significant natural and subsurface resources.⁶⁵⁰ The Kazakhstan foreign investment legal regime consists of two laws: the Law on Foreign Investments in the Kazakh SSR (Kazakh Foreign Investment Law)⁶⁵¹ and the Fundamentals of Foreign Investment.⁶⁵² These two laws provide a more detailed legal structure for making investments in Kazakhstan than laws in other Central Asian republics, but the laws lack sophistication and specificity in comparison to the Russian law.

The Kazakh law allows foreign investment in all areas of its domestic economy, except in the manufacture of products with direct military application.⁶⁵³ While the Kazakh law generally allows foreign investors to make the same types of investment as in Russia, it does not differentiate among stock or asset purchases of existing Kazakh companies and creation of new companies with foreign capital, whether partially or wholly owned by foreign entities.⁶⁵⁴ It also lacks in-depth provisions for registration, except for a 30-day period within which the Kazakh Ministry for Foreign Economic Relations must approve or deny the registration.⁶⁵⁵ Unlike the Russian law, Kazakh law does not require the investor to make capital contributions to the new company within a set period of time; the law, however, does require the enterprise to commence operations within one year from the issuance of the registration.⁶⁵⁶ Makers of small investments must register in Kazakhstan with the local Councils of People's Deputies, while larger enterprises must register with the Ministry of External Economic Relations.⁶⁵⁷

Unlike the Ukrainian and Belarussian laws, Kazakh law does not permit outright ownership of land by foreign entities.⁶⁵⁸ Instead, as

⁶⁵⁰ See Shapiro, *Foreign Investment Opportunities in Kazakhstan*, East/West Exec. Guide, Dec. 1992, at 12 (source on file with the authors).

⁶⁵¹ For an English translation of the Law on Foreign Investments in the Kazakh SSR, see SOVIET BUS. L. REP., June 1991, at 8-9, available in LEXIS, Nexis Library, RCBLR File [hereinafter Kazakh Foreign Investment Law]; see also *Russian, Kazakh Foreign Investment Laws Offer Both Similar and Different Incentives*, SOVIET BUS. L. REP., Oct. 21, 1991, available in LEXIS, Nexis Library, RCBLR File.

⁶⁵² For an English translation of Kazakhstan Law on Fundamentals of Foreign Economic Activity of January 17, 1991, see LEGAL AND PRACTICAL ASPECTS OF DOING BUSINESS IN THE SOVIET REPUBLICS, at 171 (PLI Handbook Series No. 604, 1992).

⁶⁵³ Kazakh Foreign Investment Law, *supra* note 651, art. 7.

⁶⁵⁴ *Id.* arts. 1-4, 18.

⁶⁵⁵ *Id.* art. 7.

⁶⁵⁶ *Id.*

⁶⁵⁷ *Id.*; see also *Foreign Investment Differences in Ex-USSR*, BUSINESS EASTERN EUROPE, July 6, 1992, at 322, available in LEXIS, Europe Library, Bueeur File.

⁶⁵⁸ Article 3 of the Kazakh Foreign Investment Law does not explicitly provide for foreign ownership of land or natural and subsurface resources. See Kazakh Foreign Investment Law,

is the case in the Russian Federation, long-term leases of land and concessions for the use of natural and subsurface resources are available to enterprises with foreign investment.⁶⁵⁹ Unlike the Russian law, the Kazakh law also fails to describe the method in which profits will be repatriated, particularly profits denominated in domestic currency such as rubles, and the exchange rates to be used.⁶⁶⁰ A foreign exchange tax was recently introduced, which ranged from 30 percent to 60 percent payable by exporters of specified products and commodities.⁶⁶¹ No explicit foreign exchange preferences to enterprises with foreign investment, however, are set forth in the law.⁶⁶² Tax benefits in Kazakhstan are exclusively dependent on the particular sector of the economy in which the foreign investment is made,⁶⁶³ rather than particular geographic regions.⁶⁶⁴ For Kazakh enterprises with more than 30 percent foreign capital, a full tax holiday is offered for five years followed by another five-year period at one-half of the regular tax rate.⁶⁶⁵ Property contributed to the charter fund of the Kazakh enterprise with foreign investment is to be duty free.⁶⁶⁶ Unlike the Russian duty exemption, the Kazakh exemption does not set any time limits on the importation of such property.⁶⁶⁷ Similarly, the Kazakh law lacks a provision which determines the origin of goods, necessary under the Russian law, to qualify the enterprise with more than 30 percent of foreign capital to export such goods duty-free.⁶⁶⁸ Similar to the Russian Foreign Investment Law, the Kazakh law grants the foreign investor consid-

supra note 651, art. 3. Furthermore, Article 19 of the Law on Property in the Kazakh SSR of December 1990, clearly states that land and natural resources remain in exclusive ownership of the state.

⁶⁵⁹ *Id.* art. 3; *see also* Law on Concessions in the Republic of Kazakhstan, Dec. 1991 (source on file with the authors).

⁶⁶⁰ *See* Kazakh Foreign Investment Law, *supra* note 651, art. 2.

⁶⁶¹ *See* Anulova, *supra* note 644, at 350.

⁶⁶² *Id.*

⁶⁶³ Kazakh Foreign Investment Law, *supra* note 651, art. 21 & annex; *see also* *Foreign Investors' Tax Preferences in Ex-USSR*, BUSINESS EASTERN EUROPE, July 13, 1992, at 338, available in LEXIS, Europe Library, Bueeur File.

⁶⁶⁴ Kazakh Foreign Investment Law, *supra* note 651, art. 21.

⁶⁶⁵ *Id.* art. 20. A separate legislative act, Law on Free Economic Zones in the Kazakh SSR, provides additional advantages for foreign investors establishing enterprises with foreign investment in the specified free economic zones, such as tax holidays from two to five years, tax exemptions for reinvested profits or for profits on goods sold within the republic, other tax benefits, a simplified registration procedure, and customs clearance. *See Excerpts of Kazakh Law on Free Economic Zones, translated in Kazakhstan Continues Building Legal Regime for Foreign Investment*, SOVIET BUS. L. REP., available in, LEXIS, Nexis Library, RCBLR File.

⁶⁶⁶ Kazakh Foreign Investment Law, *supra* note 651, art. 16.

⁶⁶⁷ *Compare id.* with Russian Foreign Investment Law, *supra* note 158, art. 24.

⁶⁶⁸ *See* Russian Foreign Investment Law, *supra* note 158, art. 25.

erable flexibility in the area of labor relations, including the possibility of using its own employment agreements.⁶⁶⁹ Furthermore, as with the Russian law, the Kazakh law provides that the terms of such employment contracts may not be less advantageous to Kazakh employees than those mandated by Kazakh labor laws.⁶⁷⁰ The law states that questions of hiring, firing, compensation, and other terms are regulated by collective bargaining agreements or individual contracts, and also requires the foreign investor to provide training for local employees in any new technology such foreign investor introduces in the republic.⁶⁷¹

CONCLUSION

In 1992, a foreign investor in the republics formerly constituting the U.S.S.R. was greeted with even more uncertainty than in previous years of Soviet reform. Ironically, together with the political progress toward democracy and economic liberalization, the instability inherent in the Soviet Union's break-up, the chaos resulting from the profound political changes within the newly independent republics of the fragile Commonwealth, and the utter failure of the economies of the C.I.S. republics severed by the disintegration of orderly inter-republican commerce and trade make the "big picture" of the forthcoming foreign investment environment a big blur. It is even more ironic that some western firms, while officially supporting economic and political reforms in the former Soviet Union, felt more comfortable dealing with the former, economically backward and reactionary political regime which offered a degree of certainty and stability than they are today dealing with a nation struggling toward democracy and market economics. It is completely understandable, nonetheless, that western business entities ordinarily exercise caution with respect to the fledgling Russian market economy which lacks the essential institutions and traditions of a developed capitalist society.

Along with the risks present in this type of transitional environment, there are rewards for the shrewd and well-informed investor. With regard to the long-term effects of legal regulation of foreign investment, there exists a promising resolution of the legal conflicts and inconsistencies of the old Soviet federalist system. As previously

⁶⁶⁹ Kazakh Foreign Investment Law, *supra* note 651, art. 12.

⁶⁷⁰ *Id.*

⁶⁷¹ *Id.*

discussed, the new republican codes of foreign investment and their accompanying domestic commercial legislation, particularly in the Russian Federation, are more in line with the legislation in market-oriented countries. Developed western countries generally do not have specific legislation on foreign investment, although the rights of foreign investors may be regulated by other domestic laws. Clearly, progress has been made to accommodate the foreign investor and to grant it various assurances and guarantees that its investment will not be arbitrarily and adversely affected by government regulation or action. Some progress has also been made, particularly in the Russian Federation, toward enacting a comprehensive legal structure for regulating various commercial transactions, although inconsistencies, ambiguities, and conflicts still permeate Russian domestic law. The biggest obstacle to the western investor, because of the complexity of regulation, instability of the substantive law and, most of all, the undying national tradition of xenophobia, is undoubtedly the Russian bureaucracy, whose hostile attitude toward private business and especially foreign business, has remained intact through centuries of various incarnations of the Russian empire.

Although the regional infighting may continue, its effect will no longer be as paralyzing as that of the "war of laws" during the centralized Union, when the foreign investor had to deal with and to satisfy the all-Union, the individual republican, and one or several local levels of authority and regulators. From now on, Republican laws will govern investment in the C.I.S. republics and will be the supreme law on the subject. Furthermore, foreign investment laws across the former Soviet Union appear fairly uniform, with only a few fundamental distinctions existing in the treatment of foreign investors which relate to aspects of business operations. This uniformity also can be expected to exist to a greater extent in the former U.S.S.R. than in eastern Europe, where despite several decades of Soviet domination and repression, different economic and cultural backgrounds of the eastern European nations resulted in greater differences.

In spite of the newly-found political independence, most republics of the former U.S.S.R. will be bound closely together in economic and perhaps political matters. Even in the absence of strong cooperation provisions in the commonwealth treaty and in multilateral treaties between such republics, these new independent states have very strong historical, cultural, and economic ties. Consequently, even those investors with operations in one C.I.S. republic need to be aware of the legal, economic, and political developments in the

whole territory of the Commonwealth due to the close interdependence of former Soviet republics.

This discussion would not be complete without the following qualification: purely legislative analysis of the Russian foreign investment regime as seen solely through the literal reading of the laws enacted by the newly formed populist Russian government may be rather deceptive and misleading to a western investor. It must be emphasized that the Russian commercial environment, being distinctly unique from that of western Europe and North America, additionally requires some rudimentary understanding of the Russian cultural milieu—in particular, the manner in which Russian leaders have traditionally adopted western influences.

The new economic and legal systems emerging in Russia on the ruins of communism were clearly inspired by western notions of democracy and free market, and their survival may be dependent on western capital and technology. It is important to recognize, however, that similar imports of western political and economic ideology on the wholesale scale have occurred in Russian history before with mixed results. The previous rulers of Russia, from Peter the Great to Catherine the Second, have all made tremendous progress in transforming their country literally overnight in spite of the strong internal opposition to their ideas. The changes were invariably undone by the successor's regime or so materially modified during the reign of the initiator as to resemble nothing of the original western influence that inspired the previous reform-minded ruler.

It is thus critical for western investors in the former Soviet Union to exercise caution and to maintain vigilance in undertaking business ventures purely on reliance of the texts of the new legislative acts governing their rights and obligations. While the significance of the new foreign investment legislation should not be underestimated, one must be mindful of the enormous undertaking inherent in the radical conversion to an open and free market economy. Although the sincerity and resolve of the post-Soviet leaders of Russia and other C.I.S. republics in carrying out economic reforms should not be questioned, the feasibility of market economic relations in the short term and the shortcomings of the transitional economic system should be taken into account in every investment plan.

While history does not necessarily repeat itself, the macroeconomic and socio-political dimensions of western investment in Russia should be carefully examined in light of current historical

trends. The end result of the present reform carried out by the Russian and other C.I.S. governments in the traditional "from the top down" Russian approach is that the establishment of new market economic structures is meeting with great resistance from low-level and mid-level government bureaucrats, labor force, and apparatchiks operating in the former shadow "black market" underground economy. For purely economic—not ideological—reasons these groups thrived in the former Soviet version of market socialism, and they fully intend to protect their interests in the new economic conditions of the market-oriented system. The effect of this internal struggle on the western investor is two-fold. First, the western investor should be aware that while the old Soviet economic system has been destroyed, its vestiges remain firmly ingrained in the mentality of post-Soviet citizens. More importantly, new institutions and infrastructure suitable for a market economy have not been established. Secondly, the implementation of new economic programs and enforcement of new laws enacted to regulate commercial relations in a market economy is chaotic, arbitrary, and sometimes contrary to the clear purposes of such programs and laws. This unquestioningly calls for something other than a literal reading of the new foreign investment and supporting commercial laws of the post-Soviet republics of the Commonwealth on the part of the western investor.

Although any individual investor has little, if any, control over such factors, the economic and political environment, should be given adequate consideration in order to make an intelligent investment decision. The authors of this article have not addressed these broad strategic issues. With respect to the legal foundations of the C.I.S. republics' foreign investment regimes, however, this article has attempted to provide investors and their counsel with the essential statutory and historical background needed to prepare and negotiate investment contracts relating to capital and property located in the republics of the former U.S.S.R.