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March 25, 1997

Via UPS Next Day Air

Mr. John C. Knechtle
Director, Legal Assessments
CEELI
American Bar Association
740 15th Street, NW
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Washington, D.C. 20005-1009

Re: Draft Law on Stimulation of Foreign Investment for the Republic of Romania
Our File No.: 999908-001

Dear Mr. Knechtle:

I have enclosed three copies of a memorandum containing my comments on the referenced Draft Law, per your letter of March 12, 1997. Please note that these comments are my personal opinion and do not represent the opinion or advice of my firm or any of its or my clients. I have also attached an updated biographical sketch.

Please feel free to contact me if you have any questions or need anything further in this regard.

Very truly yours,

N. Stephan Kinsella

NSK:sp

Enclosure

pc: Mr. Sullivan
Mr. Quintin
Mr. Nolan

M E M O R A N D U M

March 25, 1997

TO: Mr. John C. Knechtle
Director, Legal Assessments, ABA/CEELI

FROM: N. Stephan Kinsella

RE: Draft Law on Stimulation of Foreign Investment for the Republic of Romania

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The following are my comments on the referenced Draft Law. Please note that these comments are my personal opinion and do not represent the opinion of my firm, Schnader Harrison Segal & Lewis, or any of its clients. In the following, my focus, in general, is on the issue of whether and to what extent the Draft Law serves to protect private property, in particular private property related to foreign direct investment in Romania.

General Reaction

The Draft Law is commendable in that it is an attempt by Romania to add further protections to the private property of foreign investors. However, the Draft Law is problematic in that it is somewhat vague, it does not go far enough in protecting the private property of investors, and it leaves too much discretion in the hands of government in deciding whether to accord "special" treatment to investment. The Draft Law also rests on the assumption that some investments ought to be given favorable treatment, which rests on the false assumption that some investments are objectively "worse" than others, and that the government can accurately assess which investments are relatively more desirable than others. The Draft Law will result in some investors being given favorable treatment with respect to other investors, which is problematic and undesirable. To the extent possible, the Draft Law should be revised to clarify and strengthen the security of a foreign investor's property rights, as explained in more detail below. The protections provided by the law should be broadened and extended to as many investors and types of investment as possible to reduce the discriminatory treatment that the Draft Law would otherwise provide.

Preliminary Considerations

The protection of private property of foreign investors is essential if Romania is to attract foreign direct investment. This is the essential touchstone by which any proposed policy, law, regulation, or regime is to be judged. The degree to which private property rights are respected is extremely significant in attracting foreign investment. The Draft Law should be amended to clarify and strengthen the security of a foreign investor's property rights, for example by taking steps to lower political risk and taxation rates.

Many changes to the legal and political climate of Romania could be suggested to contribute to these factors. Constitutional, limited government, low taxes, respect for private property, the free market, and civil liberties contribute to both a health economy and to a low political risk.

Promulgating a pro-foreign investment law which provides for government guarantees that property rights will be respected can also play an important role in attracting foreign investment. However, as investors are all too aware, even a pro-investment law may be changed at a later time by the legislature due to the government's legislative sovereignty. A new government may desire to nationalize certain industries, for example. Thus, the ability of Romania to promulgate new laws that might override property rights previously guaranteed to investors tends to reduce the attractiveness of any government guarantees that are made. For a developing economy such as Romania, such guarantees should be made more effective by reducing the chance that the laws will change to investors' detriment.

One way to increase the likelihood that such a guarantee, once granted, will be respected by future governments is to implement a constitutionally limited government, with an independent judiciary having the power of judicial review. Another way is to make the guarantees binding under international law, since states are often reluctant to be seen as clearly violating international law. An investment agreement executed between the host state and investor accordingly may be "internationalized," so that the state's obligations contained therein are binding under international law. For example, the agreement may contain both an international arbitration clause, which grants jurisdiction to a neutral third party (such as the International Center for the Settlement of Investment Disputes (ICSID)), and a stabilization clause. A stabilization clause provides that the law in force in the state on a given date is the relevant law for purposes of interpreting the investment agreement, regardless of future legislation. This effectively "freezes" the legal regime in place on a certain date, so that any future changes in law contrary to the state's guarantees are without effect, at least under international law.

General Comments

The Draft Law essentially assumes that there is some background protection of the private property of foreign investors, such as that provided by international law, other municipal laws in force, or by treaties entered into by Romania (see, e.g., Art. 3). The Draft Law then attempts to add another measure of protection to foreign investors by providing for various tax and custom duty exemptions or favorable rates, and other incentives, if the investment qualifies for such treatment under the Draft Law or in the determination of the Government. (Art. 4.)

One problem with the foreign investment regime established by the Draft Law is that it will result in some types of investment being favored over others. This presumes that some types of investment are objectively superior, more efficient, or otherwise more preferable than others;

and that the Government accurately assess proposed investments accordingly. However, government is notoriously incapable of determining which type and amount of investment or other capital allocation is efficient or proper. This is why Russian-style centralized economic planning has failed so disastrously. Economic planning on a more modest scale is also unwise. Government is unable to centrally collect the relevant information that would be required to efficiently allocate capital; and even if all the relevant information could be centrally collected, government is unable to efficiently allocate capital since centralization destroys the private property and market price system that otherwise efficiently allocates capital.[1] Further, even assuming away these problems, decisions will tend to be made or at least influenced by political factors, such as favoritism, corruption, bribery, and special interest lobbying.

Another problem with the Draft Law is that at least some of the incentives provided are provided only at the discretion of the Government. The incentives provided in Arts. 6 and 7 appear to be available as long as the more or less objective conditions of Art. 5 are met. However, the additional incentives contemplated under Art. 8 are available only if the Government so approves; and the amount and types of incentives to be provided appear to be wholly within the discretion of the Government or the Romanian Development Agency (RDA). Further, it is not clear that an investor denied the incentives under Arts. 6 and 7 have any legal recourse to challenge this decision, so the incentives of these Arts. appear to be discretionary as well, for all practical purposes. (Additionally, the incentives under Arts. 6 and 7 require the RDA's approval. Art. 5.)

One problem with such discretion is that it is bound to be misused for corrupt or petty purposes—e.g. influenced by bribery, special interest group lobbying, and other forms of political favoritism—from time to time. This will lead to an inefficient selection of favored investments. Further, such discretion will make Romania a less attractive home state for investment from the outset, since the discretion increases the uncertainty as to whether the investor will be able to obtain the maximum incentives available. Such favoritism can also cause an investor to fear being put to a competitive disadvantage with other investors receiving more favorable treatment. Finally, giving discretion to the Government will likely lead, in the long run, to fewer favored investments than would be favored under an overall more liberal investment policy.

The law could be improved by reducing this discretion, and by providing for a legal right of an investor to challenge a decision relating to the approval of these incentives in a Romanian court, or, better yet, in an international arbitration forum.

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[1]For more discussion of the problems of centralized economic calculation, see Paul E. Comeaux & N. Stephan Kinsella, *Protecting Foreign Investment Under International Law: Legal Aspects of Political Risk* (Dobbs Ferry, New York: Oceana, 1997), app. I; Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* (J. Kahane trans., Liberty*Classics* 3d rev'd ed. 1981); Ludwig von Mises, *Human Action: A Treatise on Economics* (3d rev'd ed. 1966), pp. 200-31, 695-715; Murray N. Rothbard, "The End of Socialism and the Calculation Debate Revisited," 5 *Rev. Austrian Econ.* 51 (1991); *Collectivist Economic Planning* (F.A. Hayek ed., 1935).

As mentioned above, favoritism or discrimination in investment treatment can be problematic. Ideally, there should be no discrimination between foreign investors, on the basis of nationality or any other criterion. Rather, all foreign investors (and, for that matter, municipal or local investors) ought to enjoy equal, i.e. MFN treatment. Otherwise, foreign investors could be justifiably concerned that competition between them is not fair.

A superior alternative, then, to the present regime contemplated by the Draft Law would be to accord the maximum feasible protection of private property rights to *all* foreign investors and types of investment. This would reduce the overhead expenses associated with government oversight, reduce corruption, and spur overall investment to a greater extent than would be obtained from piecemeal and discretionary favorable treatment.

Another general consideration concerns bribery and corruption. Bribery and corruption of public officials is well-known in many developing countries. However, American investors are prohibited by the Foreign Corrupt Practices Act (FCPA), 15 U.S.C. § 78m(b) *et seq.*, from engaging in such activities. If bribery and political corruption are widespread in Romania, American investors will be at a competitive disadvantage with respect to investors from other regions such as Western Europe. Thus, given the existence of the FCPA, the existence of widespread bribery and corruption will tend to reduce American investment in Romania.

It is preferable, for the reasons given above regarding internationalization of obligations, that the Draft Law be given as much force as possible by internationalizing it, for example by making its terms part of a multilateral treaty or bilateral investment treaties (BITs), or by incorporating its provisions into internationalized, stabilized investor-state contracts. Romania also ought to attempt to strengthen the protections of private property and foreign investment provided in BITs and other treaties. Romania also ought to support the negotiation of the OECD's multilateral agreement on investment (MAI), and seek to accede thereto as soon as possible.[2]

The Draft Law should include a Statement of Principles that clearly indicates that Romania recognizes the importance and sanctity of private property, and that purpose of the Draft Law is to protect the private property rights of foreign investors. Such a statement may be useful in persuading investors that Romania is serious in its commitment to protecting and respecting investors' property rights. This statement would also increase the chance that the Draft Law, in cases of ambiguity, would be interpreted in favor of investors' property rights.

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[2]For further discussion of the MAI, see "American Bar Association Section of International Law and Practice Report to the House of Delegates: Multilateral Agreement on Investment," 31 *International Lawyer* 205 (1997); and William H. Witherell, "Developing International Rules for Foreign Investment: OECD's Multilateral Agreement on Investment," 32 *Business Economics* 38 (January 1997).

"Foreign investment" is insufficiently defined in the Draft Law. Further, it is often unclear whether contractual rights are considered to be property rights on an equal footing with other types of property rights. The Draft Law should clearly define foreign investment, and should provide that foreign investment includes "property" and "property rights" or foreign investors, including immovables and movables, corporeals and incorporeals, intellectual property rights, and contract rights. As a general matter, it is preferable to adopt general terminology or concepts utilized in or compatible with established Western legal systems, primarily Anglo-American common-law concepts and terms.

Detailed Comments

The following comments are made with reference to the relevant section of the Draft Law. These comments assess various provisions of the Draft Law without further criticizing the Draft Law's assumption that favorable investment conditions will be accorded only to some investors or types of investment, and only at the Government's discretion. Thus, the suggestions below are aimed at strengthening the investment protections currently provided by the Draft Law, even though it would be preferable if these investment protections would not be handed out selectively by the Government.

Art. 2. The term "foreign capital companies" is not well-defined. Also, the fact that the treatment to be given to such companies is to be "in accordance with the laws in force" serves to reduce the certainty of any guarantee of treatment by making it conditional on laws in force.

Art. 5. The capital requirements ought to be lowered as much as feasible to extend the favorable coverage provided by the Draft Law to as many investments as possible.

Art. 6. The term "contribution in cash effectively disbursed" is confusing and unclear.

Art. 7. The three-year exemption from payment of import customs and value-added taxes ought to be extended as much as possible, for example to six, ten, twenty years, or longer. Another useful change would be to allow the exemption period to be indefinitely repeated for an investor. This automatic renewal of protections could be usefully applied to other favorable treatments provided by the Draft Law.

A problematic aspect of Art. 7 is the provision that the exemptions provided therein are conditioned upon the investor's securing of financing of imports using sources from abroad that do not encumber Romania's "balance of payments." This ought to be completely deleted from the Draft Law, since it rests on the economically fallacious (but widespread) mercantilist idea that there can be a "favorable" or "unfavorable" balance of trade. Unlike a budget deficit, which is undesirable, it is irrelevant whether there is a trade "surplus" or "deficit," since this results from the sum total of a large number of individual credit transactions, each of which presumably

benefits both parties thereto.[3] Developing economies ought to be careful not to adopt fallacious economic doctrines unwisely adopted in the West in this century. While the West's free-market systems are worth emulating, various Western policies are not, such as our anti-trust laws, fiat-money and Federal-reserve-controlled banking system and other Keynesian-based institutions and policies, protectionism, and the like.

Art. 8 contains several possible "additional incentives" that are unacceptably vague, such as "high technology," "free writ of possession over land," and the like.

Art. 9 states that the RDA provides investment counseling to foreign investors. It is not clear why this ought to be monopolized or even engaged in by a government agency. Private enterprise would better fill this need.

Art. 13. The prohibition against nationalization or expropriation of investments should be clarified and broadened, to clarify that these concepts include both indirect and creeping expropriation.

Arts. 13 and 14. The provision for compensation in the event of a (lawful) expropriation should be clarified to provide that the full, market value of nationalized property will be paid to the expropriated investor, and the concept of "equitable" principles enunciated in Art. 14 ought to be examined to ensure that there is no implication that less than full compensation can be awarded. Additionally, the following standard should be adopted to make clear to investors Romania's commitment to the sanctity of the investors' property rights: the standard of compensation should be the *greater* of the full market value of the investment, *or* the commercial value *to* the investor (which may be greater than the market value due to synergy, etc.) Further, the Draft Law should clarify that any taking is "illegal" if not done for a public purpose, or if done in a discriminatory manner. This will help to dissuage Romania from engaging in such an expropriation for fear of being seen as commiting an unlawful taking, which should help to ensure investors that Romania is sincere and serious about respecting the property rights of investors.

Art. 15 provides for a disputed amount of compensation to be established "through the courts of law, in accordance with the legal provisions." It is unclear to what "the legal provisions" prefers. It is also unclear whether "the courts of law" contemplates only Romanian courts or whether international arbitration is available. Courts should be empowered to nullify

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[3]For further discussion of the fallacy that a balance of trade deficit is harmful to an economy, see Murray N. Rothbard, *Man, Economy, and State: A Treatise on Economic Principles* (1962), ch. 11, § 10; Ludwig von Mises, *Human Action: A Treatise on Economics* (3d rev'd ed. 1963), ch. XVII, § 14; Frederic Bastiat, *Economic Sophisms* (Arthur Goddard trans., Foundation for Economic Education ed. 1964), ch. 6; David Boaz, *Libertarianism: A Primer* (1997), pp. 176-81; *Clichés of Politics* (Mark Spangler ed., 1994), § 72, p. 260.

the effects of an illegal taking or nationalization. Further, international arbitration should be authorized, and commitments in the Draft Law internationalized if possible, as discussed above.

Art. 17. "Non-mediated foreign investment" is unclear in meaning, and consequently the meaning and purpose of this article is unclear as well.

Art. 19. The certificate of investor ought to be internationalized, e.g., by stabilization and international arbitration clauses, or protected through BITs or other treaties if possible.

Recommended Commentary

Paul E. Comeaux & N. Stephan Kinsella, *Protecting Foreign Investment Under International Law: Legal Aspects of Political Risk* (Dobbs Ferry, New York: Oceana, 1997)

Paul E. Comeaux & N. Stephan Kinsella, "Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance," 15 *New York Law School Journal of International & Comparative Law* 1 (1994) (copy attached)

N. Stephan Kinsella, "Lithuania's Proposed Foreign Investment Laws: A Free Market Critique," *Russian Oil & Gas Guide*, Apr. 1994, at 60 (copy attached)

Bernard H. Siegan, *Drafting a Constitution for a Nation or Republic Emerging into Freedom* (2d. ed. 1994)

Robert W. McGee, "Some Tax Advice for Latvia and Other Similarly Situated Emerging Economies," 13 *International Tax and Business Lawyer* 223 (1996)

Daniel T. Ostas & Burt A. Leete, "Economic Analysis of Law as a Guide to Post-Communist Legal Reforms: The Case of Hungarian Contract Law," 32 *American Business Law Journal* 355 (1995)

"Symposium: Development of the Democratic Institutions and the Rule of Law In the Former Soviet Union," including the article by Judith Thornton, "Economic Reform and Economic Reality," 28 *John Marshall Law Review* 847 (Summer 1995)

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March 12, 1997

Mr. N. Stephan Kinsella
Schnader, Harrison, Segal & Lewis
1600 Market Street, Suite 3600
Philadelphia, PA 19103-4252

Dear Mr. Kinsella:

Thank you for agreeing to review the draft Law on Stimulation of Foreign Investment for the Republic of Romania.

We will write the analysis based on our background research and the comments and other information we receive. In making your comments, we prefer a thematic, policy-oriented analysis rather than a line-by-line critique of the law. We are working with translations, so please do not focus on syntax or vocabulary unless they are critical. I have enclosed general guidelines, which are only suggestions for structuring your comments. We need to receive your comments by March 26, 1997. Although we do not include copies of the comments we receive in our final report, the comments are sent, through our liaison, to those individuals who requested the assessment. We therefore would like to receive a hard copy of your comments that we can forward to our liaison.

In addition to your comments, please feel free to provide us with any materials that could be included as an appendix to our final report. We frequently use sample U.S. or foreign laws on the same issue as appendices; reports or articles that discuss the issue are sometimes helpful.

If you have any questions, please feel free to call me or Ana Sljivic at (202) 662-1953 or via e-mail at ASljivic@abaceeli.org. We are looking forward to receiving your comments on the draft law.

Sincerely,

John C. Knechtle
Director, Legal Assessments

Enclosures

cc: Mark S. Ellis, Executive Director, CEELI

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October 22, 1996

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Re: Nizhny Novgorad Oblast for Russia: Draft Law on Foreign Investment Activities

Dear Mr. Knechtle:

I have enclosed three copies of a memorandum containing my comments on the referenced Draft Law, per your letter of October 9, 1996. I thank you for the opportunity to present my comments in this regard, and hope that they are of some use in the preparation of your final report. Please note that these comments are my personal opinion and do not represent the opinion or advice of my firm or any of its or my clients. As you requested, I have also attached a brief biographical sketch.

Please feel free to contact me if you have any questions or need anything further in this regard.

Very truly yours,

N. Stephan Kinsella

Enclosure

M E M O R A N D U M

October 21, 1996

TO: Mr. John C. Knechtle
Director, Legal Assessments, ABA/CEELI

FROM: N. Stephan Kinsella NSK

RE: Nizhny Novgorad Oblast for Russia: Draft Law on Foreign Investment Activities

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I have reviewed the referenced Draft Law, as well as the Explanatory Note to same. The following are my comments on the Draft Law. Please note that these comments are my personal opinion and do not represent the opinion of my firm, Schnader Harrison Segal & Lewis, or any of its clients.

General Reaction

The Draft Law is a largely commendable attempt to welcome foreign investment into the oblast, despite apparently being somewhat hampered by boundaries imposed by controlling laws of the Russian Federation. Within these boundaries, the Draft Law should be amended to clarify and strengthen the security of a foreign investor's property rights, as explained in more detail below. To the extent the oblast has influence over laws of the Russian Federation or their applicability to the oblast, the oblast should seek to have the laws of the Russian Federation similarly amended.

Preliminary Considerations and General Comments

The Explanatory Note explains that the Legislative Assembly's main objective in considering the enactment of a law modeled after the Draft Law is to render the oblast as attractive as possible to foreign investors, within the bounds of Russian Federation laws. The Explanatory Note properly recognizes that various factors tend to attract foreign investment, including: a stable political and economic situation (low political risk); convertibility and stable rates of national currency; low taxation; and reliable government guarantees of private property rights. Another factor, not explicitly mentioned, but which also attracts foreign investment, is a healthy economy.

Low political risk, low taxation, and a healthy economy are extremely significant factors in attracting foreign investment. The Draft Law generally favors these factors, but more could be done to bring these things about. The Draft Law should be amended to clarify and strengthen the security of a foreign investor's property rights in view of these factors.

Many changes to the legal and political climate of the oblast and Russia itself could be suggested to contribute to these factors. Constitutional, limited government, low taxes, respect for private property, the free market, and civil liberties contribute to both a health economy and to a low political risk.

Promulgating a pro-foreign investment law which provides for government guarantees that property rights will be respected can also play an important role in attracting foreign investment. However, as investors are all too aware, even a pro-investment law may be changed at a later time by the legislature due to the government's legislative sovereignty. A new government may desire to nationalize certain industries, for example. Thus, the ability of Russia or the oblast to promulgate new laws that might override property rights previously guaranteed to investors tends to reduce the attractiveness of any government guarantees that are made. Especially for a developing economy such as Russia and its component units, in which there has been a history of hostility to private property rights, such guarantees should be made more effective by reducing the chance that the laws will change to investors' detriment.

One way to increase the likelihood that such a guarantee, once granted, will be respected by future governments is to implement a constitutionally limited government, with an independent judiciary having the power of judicial review. Another way is to make the guarantees binding under international law, since states are often reluctant to be seen as clearly violating international law. An investment agreement executed between the host state and investor accordingly may be "internationalized," so that the state's obligations contained therein are binding under international law. For example, the agreement may contain both an international arbitration clause, which grants jurisdiction to a neutral third party (such as the International Center for the Settlement of Investment Disputes (ICSID)), and a stabilization clause. A stabilization clause provides that the law in force in the state on a given date is the relevant law for purposes of interpreting the investment agreement, regardless of future legislation. This effectively "freezes" the legal regime in place on a certain date, so that any future changes in law contrary to the state's guarantees are without effect, at least under international law.

It is my understanding that the oblast is not a state under international law, but is instead a political subdivision of the Russian Federation. Therefore, the cooperation of the Russian Federation would appear to be necessary in order to properly provide for any internationalizations of agreements. Likewise, any constitutional changes in favor of limited government and a free-market economy, would presumably require appropriate authorization from the Russian Federation. Therefore, although movement in these directions is in my view desirable, below I will discuss primarily unilateral changes that may be made to the Draft Law that do not necessarily require cooperation with the Russian Federation.

Detailed Comments

The following comments, where possible, are made with reference to the relevant section of the Draft Law.

A presumption of legality should be included, to the effect that any type of investment not specifically prohibited by the Draft Law is legal. Art. 26 appears to contain a similar presumption, but, if so, this should be clarified.

It is often unclear whether contractual rights are considered to be property rights on an equal footing with other types of property rights. The Draft Law should clearly provide that "property" and "property rights" include immovables and movables, corporeals and incorporeals, intellectual property rights, and contract rights.

Another general consideration concerns bribery and corruption. Bribery and corruption of public officials is well-known in many developing countries. However, American investors are prohibited by the Foreign Corrupt Practices Act (FCPA), 15 U.S.C. § 78m(b) *et seq.*, from engaging in such activities. If bribery and political corruption are widespread in the oblast, American investors will be at a competitive disadvantage with respect to investors from other regions such as Western Europe. Thus, given the existence of the FCPA, the existence of widespread bribery and corruption will tend to reduce American investment in the oblast.

Art. 1. A Statement of Principles should clearly indicate that the oblast recognizes the importance and sanctity of private property, and that purpose of the Draft Law is to protect the private property rights of foreign investors. Such a statement may be useful in persuading investors that the oblast is serious in its commitment to protecting and respecting investors' property rights. This statement would also increase the chance that the Draft Law, in cases of ambiguity, would be interpreted in favor of investors' property rights.

Art. 2: Definitions. "Investment Agreement" ought to be clearly defined as a listed, defined term. Its status under international law should be clarified, with a view towards making it clear that any obligations or guarantees undertaken by the oblast in the Draft Law are to be considered binding under international law (to the extent permissible under both Russian Federation law and international law).

Art 3. I was unclear as to whether "Participants" in foreign investment, who may be Russian citizens, could also be oblast citizens or not.

Art. 5. This article prohibits foreign investment that "violates legislation of the RF [Russian Federation] and the oblast." This seems to be an awfully broad exception. It should be narrowed as much as feasible. For example, the oblast legislation that prohibits certain types of investment could be listed, and the Draft Law could provide that no further prohibitions will be

enacted. The law could at least make it clear that any existing foreign investments are exempt from changes in the law that render that type of investment unlawful. (Art. 14, discussed below, contemplates only a three-year stabilization.)

Art. 6. The oblast is stated to have an obligation to ensure proper fulfillment of terms on which foreign investments were attracted. This obligation should be asserted more directly and forcefully, and its nature clarified—e.g., is it an obligation under international law? Russian Federation law? Oblast law only? Also, there seem to be no consequences to the oblast if it does not fulfill this obligation (e.g. is it subject to lawsuit by a foreign investor?).

Art. 7. Equal treatment of investors is mandated (paragraphs 2-3), but this appears to be contradicted by the last paragraph, which allows special privileges to be set up for some investors. It would be preferable to delete paragraph 4, to prevent discrimination and also to reduce the chance that the oblast government will engage in inefficient determinations of which types of investment are "most important." (Art. 16 also contemplates such special privileges.)

Art. 8. This article contemplates legal measures taken by the oblast against "unfair competition," which presumably includes Western-style anti-trust type laws. While a legal monopoly, such as the government's monopoly over the printing of money or the building of roads, are true monopolies, the concept of a non-legal monopoly has always been problematic, and legal systems would be well-served to abolish this concept.[1] Typically, "monopoly power" or "economic power" is attributed to successful companies that grow and prosper due to innovation, efficiencies, and satisfaction of customer demands. To punish firms for being "monopolistic" is to punish success and prospering. The oblast should not persecute successful companies, but should instead encourage success to attract foreign investment.

Also in art. 8, certain numbered obligations are "taken" by the oblast. These obligations should be made subject to international law, if possible. Also, (1), concerning creating a "favorable" image in the region for foreign investment, is vague; (3) is unclear in meaning; (6), concerning compensation, should be amended to read "to fully and promptly compensate for losses . . . ." Regarding (1), although this suggestion is not directly relevant to the Draft Law itself, the oblast should consider setting up a Web Site on the World-Wide Web to promote itself.

Art. 9 concerns funds for the oblast's "state guarantees security." I found this unclear, and it seems to be insufficiently integrated with and related to the rest of the Draft Law. Are these funds for paying for damages resulting from expropriations of property and the like? Also,

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[1]See Murray N. Rothbard, *Man, Economy, and State: A Treatise on Economics* (3d. ed. 1966), at 604-15, discussing "The Illusion of Monopoly Price on the Unhampered Market," and Hans-Hermann Hoppe, *A Theory of Socialism and Capitalism: Economics, Politics, and Ethics* (1989), section entitled "Fallacies of the Public Goods Theory and the Production of Security."

if so, provision should be made to place such funds with a neutral third-party escrow agent located outside the Russian Federation's jurisdiction.

Art. 10. The financial measures such as provision of loans, surety, etc., should not be handled by the oblast, but should be allowed to be serviced by firms on the market. Government involvement in such activities is unnecessary and can distort the market. The availability of private insurance is a better indicator of the true riskiness of investing in the oblast.

Art. 11. "Expropriation" should be added to the list of types of nationalization, for clarity and completeness. The exception for nationalization, "except for the decision of the authorized Federal bodies in conformity with the RF legislation," is very broad, and greatly reduces the value of a guarantee against expropriation, as virtually any expropriation can be seen as being in "conformity with" law.

Art. 12. The guarantee against nationalization should be clarified and broadened. Specifically, "expropriation" should also be listed alongside nationalization; and it should be made clear that the *full* value of nationalized property will be paid to the expropriated investor. Additionally, the following standard should be adopted to make clear to investors the oblast's commitment to the sanctity of the investors' property rights: the standard of compensation should be the *greater* of the full market value of the investment, *or* the commercial value *to* the investor (which may be greater than the market value due to synergy, etc.) Also, the relevant interest rate should be a market rate of interest, not the interest rate of the Russian Federation (see also Art. 30 on this). Further, the Draft Law should clarify that any taking is "illegal" if not done for a public purpose, or if done in a discriminatory manner, and courts should be empowered to nullify the effects of an illegal taking or nationalization.[2]

Art. 13. The taxes required to be paid before profits may be transferred should be "any non-disputed" taxes.

Art. 14. This article appears to attempt to "stabilize" the legal regime so that laws cannot be enacted to the detriment of an investment. However, the stabilization lasts only three years, far too short a time for investors who often calculate the feasibility of an investment on the scale of decades.

Art. 21 contemplates suits in court, but the Draft Law should be clarified to clearly provide for judicial review, that is, the power of a court to overturn actions of the legislature or executive that are considered illegal under the Draft Law or other laws of the oblast or Russian

[2]For more on "takings," see Richard A. Epstein, *Takings: Private Property and the Power of Eminent Domain* (1985).

Federation. Also, the type of court is not specified: is it Russian, a court of the oblast, a court of a neutral third-party forum?

Art. 39. It is unclear whether property that may be acquired includes immovables such as *land*; even though real property is mentioned, land seems to be excluded by implication of not being listed along with less-important types of property. If so, this should be made clear (Art. 43 also implies that land can be owned by foreign investors).

Recommended Commentary

Paul E. Comeaux & N. Stephan Kinsella, *Protecting Foreign Investment Under International Law: Legal Aspects of Political Risk* (Dobbs Ferry, New York: Oceana, forthcoming 1996)

Paul E. Comeaux & N. Stephan Kinsella, "Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance," 15 *New York Law School Journal of International & Comparative Law* 1 (1994) (copy attached)

N. Stephan Kinsella, "Lithuania's Proposed Foreign Investment Laws: A Free Market Critique," *Russian Oil & Gas Guide*, Apr. 1994, at 60 (copy attached)

Bernard H. Siegan, *Drafting a Constitution for a Nation or Republic Emerging into Freedom* (2d. ed. 1994)

Robert W. McGee, "Some Tax Advice for Latvia and Other Similarly Situated Emerging Economies," 13 *International Tax and Business Lawyer* 223 (1996)

Daniel T. Ostas & Burt A. Leete, "Economic Analysis of Law as a Guide to Post-Communist Legal Reforms: The Case of Hungarian Contract Law," 32 *American Business Law Journal* 355 (1995)

"Symposium: Development of the Democratic Institutions and the Rule of Law In the Former Soviet Union," including the article by Judith Thornton, "Economic Reform and Economic Reality," 28 *John Marshall Law Review* 847 (Summer 1995)

CEELI
CENTRAL AND EAST EUROPEAN LAW INITIATIVE
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November 14, 1996

Mr. N. Stephan Kinsella
Schnader, Harrison, Segal & Lewis
1600 Market Street, Suite 3600
Philadelphia, PA 19103-4252

Dear Mr. Kinsella:

Thank you for your comments on the draft Law on Foreign Investment Activities in Nizhny Novgorod Oblast. Without your insightful analysis, we could not provide this assistance to the Nizhny Novgorod regional government or the countries of Central and Eastern Europe and the NIS.

Enclosed, please find a copy of the report that we sent to Vadim V. Mramornov, Head of the Legal Department for the Industrial Consulting Group, Ltd. based on your recommendations, the suggestions of others, and our research. If you have any questions about the report or ideas on how to improve the assessment process, please do not hesitate to contact me.

Thank you again on behalf of CEELI and on behalf of the Nizhny Novgorod regional government.

Sincerely,

John C. Knechtle
Director, Legal Assessments

Enclosure

cc: Mark S. Ellis, Executive Director, CEELI

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October 9, 1996

Mr. N. Stephan Kinsella
Schnader, Harrison, Segal & Lewis
1600 Market Street, Suite 3600
Philadelphia, PA 19103-4252

Dear Mr. Kinsella:

Thank you for agreeing to review the draft Law on Foreign Investment Activities in the Nizhny Novgorod oblast for Russia.

We will write the analysis based on our background research and the comments and other information we receive. In making your comments, we prefer a thematic, policy-oriented analysis rather than a line-by-line critique of the law. We are working with translations, so please do not focus on syntax or vocabulary unless they are critical. I have enclosed general guidelines, which are only suggestions for structuring your comments. We need to receive your comments by October 24, 1996. Although we do not include copies of the comments we receive in our final report, the comments are sent, through our liaison, to those individuals who requested the assessment. We therefore would like to receive a hard copy of your comments which we can forward to our liaison.

In addition to your comments, please feel free to provide us with any materials that could be included as an appendix to our final report. We frequently use sample U.S. or foreign laws on the same issue as appendices; reports or articles which discuss the issue are sometimes helpful. Also, please provide a brief biographical sketch of one or two paragraphs that we may include in our final report. If possible, please focus on your experiences which relate to the subject matter of the draft law. You may also send us a c.v. and we will create such a sketch. The drafters of the laws we assess frequently ask about the background of our commentators and are impressed by their qualifications and expertise in the subject matter of the draft laws.

If you have any questions, please feel free to call me or Ana Šljivić at (202) 662-1953. We are looking forward to receiving your comments on the draft law.

Sincerely,

John C. Knechtle
Director, Legal Assessments

Enclosures

cc: Mark S. Ellis, Executive Director, CEELI

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October 24, 1996

BY TELECOPY

Curtis L. McDaniel, Esq.
Eli Lilly International Corporation
Lilly House
13 Hanover Square
London W1R 0PA
England

Dear Curt:

Thanks very much for agreeing to serve as the point person for the Central European Law Committee with regard to the private international law/globalization project of the International Section. As you and I have discussed, you should communicate directly with Ken Reisenfeld, who chairs the Section's Task Force on Globalization of Law, and who serves as the Section's Liaison to the International Bar Association.

You can reach Mr. Reisenfeld at:

Kenneth B. Reisenfeld, Esq.
Haynes and Boone, L.L.P.
1225 Eye Street, NW
Eighth Floor
Washington, DC 20005-3914
Phone: 202 414 1900
Fax: 202 414 1920
e-mail: reisenfk@hayboo.com

You asked for a list of our Country Coordinators, who should be asked for their input on this project. I enclose the list. In addition, we have established communications with, and are in the

process of discussing the Country Coordinators role with, the following:

SLOVENIA

Aleksandra Janežič
Selih, Remec & Janežič
Ljubljana, Slovenia
Phone: 011 386 61 313 740
Fax: 011 386 61 133 70 98

FEDERAL REPUBLIC OF YUGOSLAVIA (Serbia & Montenegro)

Lalin Radovan
21000 Novi Sad
Zmaj Jovina 21/I
Federal Republic of Yugoslavia
Phone: 011 381 21 52 103
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CROATIA

Don Markusic
Lambert Grohmann Deissenberger Stolitzka Röhsner
Laurenzerberg 2
Postfach 230
A-1011 Vienna, Austria
Phone: 011 43 1 515 50 120
Fax: 011 43 1 515 50 50
e-mail: don.markusic@ibm.net

Linda Wells of our Committee is the Director of the Department of Commerce's Commercial Law Development Program. Once you have had a chance to talk with Ken Reisenfeld, you should contact Linda Wells, and determine whether her program will be a good source of information for you in assessing the harmonization and globalization of private international law.

Finally, a number of people have recently joined our Committee, and volunteered to get involved in Committee projects. The new members include: Steven DeLateur, Russell Kerr, Stephan Kinsella, Patricia Fernandez and Lisa Chmura. I am sending them copies of this letter, to invite them to participate under your direction in the private international law/globalization project. Once you have had a chance to speak to Ken Reisenfeld and to develop your plan of attack on this project, please share your plan with these new members, and invite their assistance. Their addresses are enclosed.

Curt, thanks very much once again for undertaking this project. We are delighted to have the benefit of your energy and input.

Sincerely,

John Coogan

cc: Rona R. Mears, Esq. (w/o encl.)
Kenneth B. Reisenfeld, Esq. (w/o encl.)
Theodore S. Boone, Esq. (w/o encl.)
Linda A. Wells, Esq. (w/o encl.)
Steven W. DeLateur, Esq. (w/o encl.)
Russell Kerr, Esq. (w/o encl.)
N. Stephan Kinsella, Esq. (w/o encl.)
Patricia Fernandez, Esq. (w/o encl.)
Lisa Chmura (w/o encl.)

Attn: Mr. John C. Knechtle
Director, Legal Assessments,
ABA/CEELI, Washington, D.C., USA

Explanatory note
to the Draft of Law

"On foreign investment activities in Nizhny Novgorod oblast of Russia"

On instructions given by the Legislative Assembly of the N.Novgorod oblast and in conformity with the normative work Plan for the year of 1996, the consulting company "Industrial Consulting Group, Ltd." and the Nizhny Novgorod oblast Committee on International and Inter-regional relations have developed the Draft of Law **"On foreign investment activities in the Nizhny Novgorod oblast of Russia".**

While working on the above mentioned Draft of Law we proceeded from the idea that foreign investments are needed both for Russia and N.Novgorod oblast - one of its subjects. That is why the main objective was to develop the Draft at most extent attractive for foreign investors without contradicting to Federal legislation and restricting the interests of oblast as well as the interests of its enterprises and citizens.

Foreign experience shows that the most intensive flow of foreign investments comes to the countries with:

- stable political and economic situation,
- convertibility and stable rate of national currency,
- taxation favorable for the foreign investment and customs regulations,
- reliable governmental guarantees.

Thus, for example, American investors proceed from the norms of profit when investing in developed countries (West Europe, Canada, Japan) of 12-15% (approximately the same norm of profit is in the USA). For the developing countries this figure increases up to 18%. According to the calculations of the American businessmen, the norm of profit in Russia due to the high risk level must be at least 25%.

Thus, when making a decision on investment in Russia in general and in Nizhny Novgorod oblast in particular, foreign investors have the right to count on more favorable conditions than they would be given in other countries (or other subjects of the Russian Federation). Hence, in case the N. Novgorod oblast is interested in attracting foreign investments to its territory, then one may speak first of all about the need of developing favorable investment environment for foreign investors and the law regulating legal relationships in this sphere has to contribute to the fulfillment of this task.

Economic situation both in Russia and oblast in itself does not sufficiently contribute to the foreign investments. According to the Nizhny Novgorod oblast Committee on State statistics (Analitical note "Activities of joint ventures in 1995" #10-11-59 of 28.03.96) and the data submitted by State Law Department in the beginning of 1996 in Nizhny Novgorod oblast there were registered 476 joint ventures of which only 115 ventures carried out practical activities, i.e. about one third of the total number. Actually this figure remained unchanged since 1994. Production volume of these ventures (in the amount of 1171,5 billion roubles) did not exceed 4% of the total volume of products manufactured in oblast, moreover 95% of this sum is attributed to the "VOLGA" Joint-Stock Company due to which practical growth of production volume, export and import of joint ventures on the territory of oblast has been reached. In the above mentioned note the Committee on State statistics makes a conclusion: "It is quite obvious that State structures have evry reason to encourage establishment and development of enterprises involving large direct investments. In this case it is possible to achieve the initial purpose of establishing Joint Ventures - providing domestic market with high quality goods, allowing to substitute a portion of imported goods of low quality, expanding the geography of export of competitive products with the involvement of hard currency resources".

Thus, both the country and the oblast can undertake effective measures in order to draw attention of foreign investors mainly through providing them with necessary guarantees and privileges.

Firstly, it is necessary to develop a comprehensive regional program for promoting foreign investments in the economy of oblast and, what is more important, to observe its fulfillment. This program should be based on the step-by-step , priority and selectiveness principles. For the development of the regional program it is possible to use Federal Comprehensive Program for Promotion of Domestic and Foreign Investments in the economy of the Russian Federation, approved by the Russian Government Resolution of October 13, 1995, which recommended to the executive powers of the RF subjects to develop similar regional programs.

Secondly, it is necessary to think over the system of providing with tax privileges (for example, complete exemption from oblast taxes for a certain time interval or payments ~~by installments~~) foreign entrepreneurs and Russian counterparts of foreign investment activities should they participate (fully or partially) in the investment projects which are of primary importance to the oblast.

Thirdly, it is necessary to create an effective access to the information database of potential foreign investors and other interested individuals in order to inform them about the economic situation in the region, its structure, branches, territories and enterprises which need investments and which are able to draw attention of foreign partners.

Fourthly, it is extremely important to provide legal and economic protection of foreign investments. An important role here may be played by the guarantees of the oblast authorities. An important guarantee would also be the establishment of Insurance Fund with the oblast authorities participation.

It is extremely important to practically (not only on paper) provide for free

transfer of profits abroad and reinvestment of capital on the territory of RF and the oblast.

So far as there is a deficit of local budget, so far the reliance can be made on non-financial incentives (assistance in acquisition of plots of land, premises, offices, warehouses, information services etc.).

It would be useful to set up oblast network of intermediate organizations which render services to foreign companies and Russian enterprises in the field of business consulting, legal sphere, exercising expertise, marketing, establishing contacts, providing security, including personal security from criminal structure impact etc.

There could be also useful the oblast Law "On investment tenders" which would regulate the issues of state-owned shares sale and develop additional guarantees for foreign investors. For example, similar law exists in the Republic of Karelia.

Thus, we should speak first of all about the necessity of risk level reduction for foreign investors in order to attract their investments on the territory of the oblast.

Despite of high risk level, foreign investors, nevertheless have serious incentives to invest both in Russia and the oblast. First of all this is an aspiration for exploring a vast market (occupation of a "niche") which until recent days was actually closed for the foreigners. It is a possibility of acquisition of access to relatively small, but at the same time rather skilled labor force as well as scientific developments competitive on any market, but which due to different reasons do not receive sufficient development.

One should not forget about the fact to which investors always paid, are now paying and will pay special attention: the infrastructure. Oblast possesses a network of highways and railroads, air-ports, river ports, gas- and petroleum pipelines, telephone, facsimile and satellite communication network (foreign capital shows noticeable interest in the development of telecommunication network), etc.

In a word, when observing certain conditions, N. Novgorod oblast may appear to be rather attractive area for foreign investors. This is just what we have taken into consideration when developing the Draft of Law.

The development of the Draft of Law took place in difficult and even unfavorable political and legal conditions, because the initial document the Law "On foreign investments in the RSFSR" was adopted in July 1991, i.e. even prior to the USSR disintegration and at the same time when the USSR Constitution and The Civil Code of the RSFSR of 1964 were in force. It abounds with such notions as the USSR, the RSFSR, Supreme Soviet, Soviet citizens, soviet currency etc. Since the adoption of this Law, the legislation of RF has undergone considerable changes. Thus, the Civil Code of RF was adopted and as its continuation - the Law "On joint-stock societies". There was also adopted a whole series of normative acts in the sphere of taxation, currency control, regulation of intellectual property copyrights and other fields which have principal meaning for investment activities including those exercised by foreigners. Thus, the above Law of 1991 works without taking into account many these and other legal acts and in many aspects contradicts to them. That is why many of its provisions became obsolete. This is

Statement recognizing franchising related activities & right to private property.

the reason of its alteration in 1993 and 1995. The subsequent amendments and addenda to the Law of 1991 were scheduled for consideration by the State Duma of RF in June this year, but have not been considered, because up to now the State Duma of RF has accumulated more than 80 Draft of Laws with the infringed dates of consideration, including the Draft of Law on insertion of amendments and addenda to the above mentioned Law of the RSFSR "On foreign investments in the RSFSR" According to the RF Federal Assembly Legislative Initiative Plan of Federation Council for the second half of the year of 1996 (approved by the Resolution of the Federation Council of RF Federal Assembly # 332-SF in August 8, 1996), amendments and addenda to the above mentioned Law will not still be introduced this year. Alongside with this, when developing the Draft of Law we could not but take into account RF Law of 1991, because it is in effect and must serve as a basis for the oblast Law. That is why the whole set of provisions of the Draft of Law submitted for consideration has been taken from it partially unaltered and partially altered with regard to the changes in RF Legislation.

Some changes may be impossible due to conflicting RF laws etc.

At developing the Draft of Law we have analyzed and taken into account virtually all acting and perspective legal basis relative to the essence of the problem: the above mentioned Law of 1991 with subsequent amendments and addenda, the Law "On Investments Activities in the RSFSR" (edition of Federal Law # 89-F3 of 19.06.1995), and other International legal Acts related to the investment activities in general and foreign activities in particular ("Agreement on Cooperation in the Field of Investment Activities" dated 24.12.1993, Resolutions of RF Government, the Decrees of the President of RF, letters of the RF State Customs Committee and State Tax Service of RF); legislative acts of the oblast level (Charter of the N. Novgorod oblast, an Agreement on division of subjects of competence and powers between State Administration of RF and authorities of N.Novgorod oblast) and others. We have also analyzed the Draft of Laws "On insertion of amendments and addenda to the Law of the RSFSR "On foreign investments in the RSFSR" which the Deputies submitted to the State Duma of RF last year and which have been rejected by the Duma under these or those reasons.

Eliminate bribery & corruption - b/c harms U.S. investor & due to FCPA.

The need for adoption of the oblast law "On foreign investment activities in N.Novgorod oblast" is stipulated not only by the fact that the Federal Law of 1991 has become obsolete and contradicts to the basic current legislation. Federal legislation on foreign investments has a number of gaps which have to be eliminated in the oblast Law. These include a specter of privileges and guarantees on the oblast level, legal rights of Russian participants of foreign investment activities, the oblast Administration incentives of foreign investment and others.

It is obvious, that only the oblast Law can take into account regional features and provide with the oblast Administration guarantees including, for example, protection of rights and interests of the subjects of foreign investment activities before Federal authorities and in court. The motivation of the adoption of the Draft of Law by the N.Novgorod oblast Legislative Assembly comes out from the provisions of clauses 71 and 72 of the Constitution of RF and the Agreement on the division of subjects of competence and powers between State Administration of RF and the authorities of N.Novgorod oblast, dated June 8, 1996.

The proposed Draft of Law by its legal nature bears a comprehensive character, i.e. it includes provisions of various branches of current legislation. We selected this way instead of developing a small, but at the same time reduced Draft of Law in the form of additional guarantees and privileges for implementing foreign investments in the N.Novgorod oblast. We found it reasonable to fill the Draft of Law with some notions which are absent in Federal legislation such as, for example, "foreign investment activities", "participants (subjects) of foreign investment activities" and others, taking into account the fact, that foreign investment is not only financing, but extended in time process which has certain phases and requires managing and supervision. We tried to provide for the new phenomena in RF legislation: concession, leasing, franchising and others. Alongside, we deliberately refused to introduce into the Draft of Law some of the provisions, attributed to the competence of Federal legislation which are there explained and regulated (for example, issues of enterprise registration and others), trying to make the Draft of Law compact and easy for understanding and implementation in practice. At the same time we tried to maximally fill the Draft of Law with the oblast Administration guarantees, including protection of rights and interests of subjects of foreign investment activities before Federal authorities and in court, attachment of status of primary significance to investment projects and others.

A considerable assistance in developing the Draft of Law and searching for necessary information was rendered by: Committee on International and Inter-regional relations of the N.Novgorod oblast Legislative Assembly (chairman is Mrs. Nina Zvereva), Deputy director of the State Duma of RF Machinery, Mr. Yeltchev Victor, Director of the Department for Economic Cooperation at the Ministry of Foreign Affairs of RF, Mr. Smirnov P.S., Representative of the Ministry of Foreign Affairs in N.Novgorod, Mr. Mitin Vyatcheslav, and also Doctor of legal sciences, professor Mr. Ustinov Valery (Ph.D.) and heads of legal department of the "Sokol" airplane construction plant, who kindly extended us their encouraging opinions on the Draft of the Law.

This Draft of Law (as any other) is not free from drawbacks and in order it could be not only adopted but could work, various opinions and comments are required. That is why we thank you for your attention to our work. Any critical comments on the Draft of Law will be appreciated.

Sincerely yours,

Vadim V. Mramornov
Head of Legal Department,
Industrial Consulting Group, Ltd.

GUIDELINES FOR ASSESSING DRAFT LAWS

The following list of topics and questions is intended to assist you in structuring your comments on draft laws. Note that not all of the topics may apply to the law you are reviewing. Also, please bear in mind that this list is only a guideline: it by no means covers all of the possible issues you may wish to address. As a general matter we have found that a thematic and policy approach is more helpful than a line-by-line analysis. We ask you to focus on issues rather than wording or grammar since problems in those areas may be due to the translation. If the draft law uses vague or inconsistent terminology, we suggest describing the defect generally, giving a few examples of offending provisions, and enumerating problems that could arise if the flaw is not corrected. Our goal is to provide helpful suggestions for the drafters to consider, not to redraft the law ourselves. To the extent possible, it will be helpful if you could compare this law to similar laws of other countries, especially Western Europe.

- **General Reaction**
  What is your overall reaction to the law? A one or two sentence response will greatly assist CEELI in preparing its summary of comments.

- **Comprehensiveness**
  Does the law cover all of the topics it claims to cover? Are important areas missing? Are any inappropriate topics included?

- **Structure and Enforcement**
  Do any governmental entities have conflicting obligations or jurisdictions? Is it clear which regulatory agencies and officials will implement and enforce the law? Does the law include realistic and effective enforcement mechanisms? Are the respective responsibilities of agencies or officials sufficiently defined? What level of governmental intervention does the law allow?

- **Procedural Issues**
  Does the law address procedural issues discussed clearly and completely? If the law requires promulgation of regulations or enactment of additional laws, does it delineate who will do this and what their mandate is?

- **Individual Rights, Democratic Ideals**
  Does the law safeguard or infringe upon individual rights? Is it consistent with democratic principles?

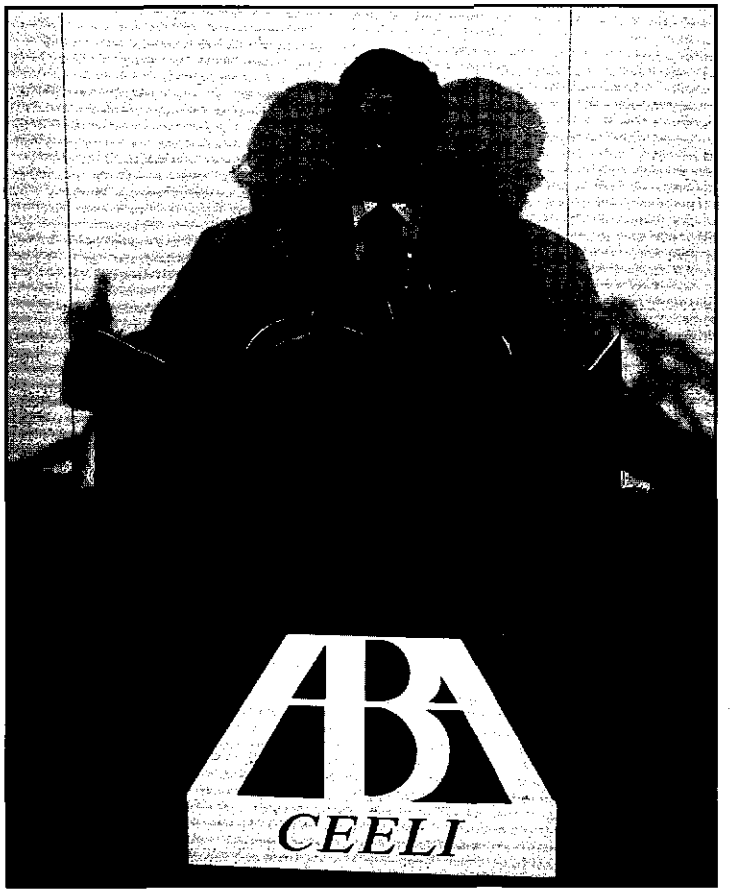
- **Promotion of Free Market Economy and Foreign Investment**
  Does the law promote or hinder the development of a free market economy? What is its effect on foreign investment?

- **Drafting**
  Is the law well-organized? Does it use terminology in a clear, realistic and consistent manner? Is the language too ambiguous or philosophical?

CEELI Update

Central and East European Law Initiative

American Bar Association | Winter 1996 | Vol. VI, No.4



Justice Richard Goldstone Honored at CEELI/CIJ Dinner

Justice Richard J. Goldstone (pictured above), former Chief Prosecutor for the International Criminal Tribunals for Rwanda and the former Yugoslavia, was honored on October 2, 1996, at a dinner sponsored by CEELI and the CEELI-initiated Coalition for International Justice (CIJ). Over 175 people attended the dinner at the U.S. Supreme Court to pay tribute to the esteemed South African jurist who has been instrumental in directing the Tribunals' development and establishing international legitimacy for the two *ad hoc* courts created by the United Nations to prosecute those accused of committing war crimes. Attendees included CEELI Executive Board Member and Supreme Court Justice Sandra Day O'Connor, U.S. Permanent Representative to the United Nations Madeleine K. Albright, CEELI Executive Board Member Senator Nancy Kassebaum, Supreme Court Justice Ruth Bader Ginsburg, Ambassador Theogene Rudasingwa of Rwanda, and Ambassador Sven Alkalaj of Bosnia-Herzegovina.

continued on page 7

Association Attorneys of Kyrgyzstan Celebrates its First Year

On December 6, 1996, a new Board of Directors was democratically elected at the first annual meeting of the Association Attorneys of Kyrgyzstan (AAK), as mandated by the Charter of the eighty-six member organization. Over fifty-five members voted at the meeting, which was conducted at the National Library in Bishkek. After the election of the board had been completed, Temirbek Kenenbaev was unanimously selected as the new Chairman. Gulniza Kojomova, Bubujan Klycheva, Ira Polyakova, and Natalia Gallamova retained their positions on the board, and Yuri Khegai and Victor Chebyshev were newly elected. CEELI's newest liaison to arrive in Kyrgyzstan quickly became instrumental to ensuring the success of the first annual meeting.

The re-election of four of the Board's members ensures some continuity and leadership for the AAK in the coming year, as the organization looks to expand its services to include production of a legal newsletter. The addition of board members like Victor Chebyshev, the head lawyer for the National

continued on page 25

What's New...

Former Senator Nancy Kassebaum Joins the CEELI Executive Board

Inside This Issue

The American Bar Association
Central and East European Law Initiative
(CEELI)

Analysis of the Draft Law on Foreign Investment Activities in Nizhny Novgorod Oblast

November 12, 1996

AMERICAN BAR ASSOCIATION
CENTRAL AND EAST EUROPEAN LAW INITIATIVE
(CEELI)

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CEELI Co-Founders
Talbot "Sandy" D'Alemberte and Homer E. Moyer, Jr.

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November 12, 1996

Vadim V. Mramornov
Head of the Legal Department
Industrial Consulting Group, Ltd.

Dear Mr. Mramornov:

On behalf of the American Bar Association Central and East European Law Initiative (CEELI), we are pleased to provide you with our assessment of the draft Law on Foreign Investment Activities in Nizhny Novgorod Oblast.

Our analysis represents a compilation of individual comments solicited from a group of government and private attorneys and a law professor with expertise in foreign investment law. Their critiques and this report are a candid review of the draft law but do not represent an endorsement by CEELI or the ABA of this draft, or any draft, of this law.

Biographical statements of the experts who assessed the law are included in Appendix A. Appendix B contains an excerpt from THE WORLD BANK GROUP, LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT, VOLUME II, REPORT TO THE DEVELOPMENT COMMITTEE AND GUIDELINES ON THE TREATMENT OF FOREIGN DIRECT INVESTMENT, 1992. An article by N. Stephan Kinsella, *Lithuania's Proposed Foreign Investment Laws: A Free Market Critique* is included in Appendix C. Appendix D contains the Government of Sri Lanka's Policy on Private Foreign Investment. An Act Amending the Investment Incentive Code of the Republic of Liberia is found in Appendix E. Appendix F contains an article by Paul E. Comeaux and N. Stephan Kinsella, *Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance*, 15 NEW YORK LAW SCHOOL JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW 1. A copy of the proposed Law on Foreign Investment Activities in Nizhny Novgorod Oblast is in Appendix G.

We hope this information will be useful to your efforts. If we may provide you with any additional assistance, please do not hesitate to contact us. We appreciate the opportunity you have given us to work with you on this important matter. We hope there will be future opportunities to work together on this and other matters.

Sincerely,

Mark S. Ellis
Executive Director, CEELI

cc: Lee Cooper, President, ABA

Analysis of the Draft Law on Foreign Investment Activities in Nizhny Novgorod Oblast

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I. Introduction

The draft Law on Foreign Investment Activities in Nizhny Novgorod oblast is a commendable effort to promote a favorable legal environment for foreign investment in the Nizhny Novgorod oblast. The strong pro-investment policy of Nizhny Novgorod should help persuade investors to seriously consider Nizhny Novgorod as a leading candidate among the various regions of the Russian Federation in which to invest and undertake economic activities. The intent and the objective of the drafters have been to attract foreign investment to the oblast by creating a transparent, stable, and non-discriminatory legal environment.

The draft provides for all the components of an emerging market system keen to attract foreign investors. The law contains provisions on ownership of private property and offers a privatization program for foreign investors. The draft specifies the types of activities that enterprises with foreign investment may undertake. The law provides for the acquisition of shares in enterprises by foreign investors and gives foreign investors the right to land use and acquisition. The draft contains a package of investment incentives, such as privileged tax rates and so forth. These incentives are designed specially to attract foreign investors. The draft also dismantles the strict exchange rate control system that existed in Russia. This sort of legal regime is similar to those found in countries such as the United Kingdom, South Korea, China's export processing zones, and Egypt. Furthermore, the draft guarantees the rights of foreign investors. These rights include the right to national treatment, the right of repatriation of funds after payment of taxes, the right to reinvest funds in the oblast economy, the right to intellectual property, and others.

In particular, the provision for an oblast security fund,[1] from which to draw in the event of nationalization, confiscation, or other exigencies, is an important feature. Similarly, the flexibility and incentives given to foreign investors with respect to intellectual property rights, export and import of goods, profit remittances, labor relations,[2] and so forth will likely be attractive to foreign entities interested in investing in Nizhny Novgorod.

The draft does attempt to provide a full range of protections and incentives, such as providing for (1) ownership and protections against discrimination, nationalization, changes of law, and illegal acts of government bodies and officials; (2) tax incentives; (3) financial assistance; (4) express permission for transfers of funds internationally; and (5) conversion of currencies. Certain relevant topics, such as police and judicial protections and registration of ownership, are not covered, but one would expect these topics to be covered in other laws rather than here.

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[1] Article 9.

[2] Article 13, Article 27, Article 33, and Article 34.

However, there are various concerns with the draft law. First, it is not clear how much independent authority the Nizhny Novgorod oblast has vis-à-vis the federal government. Second, foreign investors may not see the additional protections contained in the draft as offering anything of real value. Another concern is whether the draft adequately takes into account long-term economic growth and social and political stability. Other key provisions that are crucial and, if adequate, provide the necessary impetus for an investor to invest in a foreign country are: (1) the standard of treatment for investments; (2) the standard of treatment for expropriation and unilateral alteration or termination of contracts; and (3) the process for the settlement of disputes.[3]

In addition, the draft contains a number of provisions that have no legal effect because they simply reference legislation of the Russian Federation and appear to be there only for comprehensive reference. To the extent the oblast has influence over laws of the Russian Federation or the applicability of federal laws to the oblast, the oblast should seek to have the laws of the Russian Federation similarly amended.

The explanatory note demonstrates that a great deal of thought has been given to the practical issues of concern to business people and the policies that necessarily underlie such legislation. These considerations are critical, and the apparently thorough review that preceded the drafting is a positive sign. The explanatory note to the draft law explains that the legislative assembly's main objective in considering the enactment of a law modeled after the draft is to render the oblast as attractive as possible to foreign investors within the bounds of Russian Federation laws. The explanatory note properly recognizes that various factors tend to attract foreign investment, including a stable political and economic situation, that is, a low political risk, convertibility and stable rates of national currency, low taxation, and reliable government guarantees of private property rights. Another factor, not explicitly mentioned but that also attracts foreign investment, is a healthy economy.

Low political risk, low taxation, and a healthy economy are extremely significant factors in attracting foreign investment. The draft generally favors these factors, but more could be done to bring these things about. The draft should be amended to clarify and strengthen the security of a foreign investor's property rights in view of these factors. Many changes to the legal and political climate of the oblast and the Russian Federation itself could be suggested to contribute to these factors. Constitutionalism, limited government, low taxes, respect for private property, the free market, and civil liberties contribute to both a healthy economy and a low political risk.

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[3] *See* THE WORLD BANK GROUP, LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT, VOLUME II, REPORT TO THE DEVELOPMENT COMMITTEE AND GUIDELINES ON THE TREATMENT OF FOREIGN DIRECT INVESTMENT, 1992, pages 35 through 44, in Appendix B. *See also* N. Stephan Kinsella, *Lithuania's Proposed Foreign Investment Laws: A Free Market Critique,* RUSSIAN OIL AND GAS GUIDE, APRIL 1994, AT 60, in Appendix C.

II. Basic Elements of a Foreign Investment Law Aimed at Attracting Foreign Investors

A. National Treatment and Most Favored Nation Treatment

Two of the basic elements of a foreign investment regime are national treatment and most favored nation ("MFN") treatment, *i.e.,* an obligation to treat foreign investors and foreign investment no less favorably than nationals and an obligation to treat foreign investors and investment from one country no less favorably than foreign investors from any other country. The draft contains such provisions in Article 7. It is suggested, however, that those principles be spelled out more clearly, since the current text, while intended to be as comprehensive as possible, creates ambiguity.

First, it should be emphasized that these two simple and unqualified obligations, namely, national treatment and MFN treatment, are among the most essential guarantees foreign investors will seek. There is no need to add further qualifications to the terms *foreign investor* and *foreign investments*, *e.g.,* to define investment as a "right of the foreign investor[ ]" or to define the national treatment as applicable to "property, property rights as well as activities of foreign investors."[4] This qualification immediately raises questions relating, for example, to the treatment of non-property rights. Once *foreign investment* and *foreign investor* are defined in the draft, the clearest guarantee provided to foreign investors would be that they will enjoy: (1) treatment no less favorable than the treatment provided to local persons and (2) treatment no less favorable than the treatment provided to any other foreign investors and investment.

Second, there should be no discrimination between foreign investors on the basis of nationality. It should be stated that all foreign investors and investments will enjoy equal, *i.e.,* MFN treatment. Whatever "special privileged regime"[5] the oblast administration creates in sectors of primary importance should extend to all foreign investors without discrimination. In this respect, a common standard of treatment provision could foresee for "treatment no less favorable than that which it accords its own nationals or companies or nationals or companies doing business in the Nizhny Novgorod oblast of Russia, if the latter is more favorable."

Unless this principle is clearly spelled out in the draft, foreign investors coming into the oblast will be concerned that competition between them will not be fair. To the extent that the oblast government finds it necessary to provide incentives to foreign investors, this should be done on a nondiscriminatory basis—in specific sectors of priority to the oblast economy but not to specific projects or to specific investors. Any preferential treatment provided on a case-by-case basis will, by definition, be discriminatory and will, therefore, not serve to create a favorable foreign investment climate in the oblast. On the other hand, it might be preferable to delete the fourth paragraph of Article 7 to prevent discrimination and also to reduce the chance that the

[4] Article 7.

[5] Article 7.

oblast government will engage in inefficient determinations of which types of investment are "most important."[6]

Third, national treatment should be interpreted as treatment no less favorable than that provided to local persons. The draft refers to Russian legal entities and citizens. Foreign investors may not know whether the oblast can discriminate against Russian persons from outside of the oblast and treat local, that is, oblast, persons more favorably. It should therefore be clearly stated that foreign investors will enjoy a treatment no less favorable than the treatment provided to local persons, meaning persons of the Nizhny Novgorod oblast. That would ensure that any incentives provided to local companies would also extend to foreign investors. It is essential that any exemptions from national treatment be specifically and narrowly defined. On the other hand, the draft contains no incentives for the development of businesses by Russian nationals themselves; thus, the draft may serve to hurt Russian nationals by putting them at a competitive disadvantage. This may force local companies to joint venture with foreign nationals.

The draft should specify that the oblast will not impose any additional requirements or restrictions on foreign investors in addition to the requirements and restrictions imposed by the law of the Russian Federation.[7] Thus, a foreign investor who has met the requirements of the Russian Federation law will not need to comply with any additional permission or registration requirements to make an investment in the oblast; once having made the investment in the oblast, the foreign investor will be subjected to no additional requirements and restrictions in operating it. It is important to make it clear that the national treatment and the MFN treatment provided to foreign investors in the oblast refer to both the pre-establishment stage, that is, making the investment, and the post-establishment stage, namely, operating the investment.

Article 6 could, in principle, lend great comfort to a potential investor, since the so-called guarantees are in addition to those provided by the Russian Federation's legislation. However, without assessing the Russian Federation's law on foreign investment, it is difficult to conclude that there is adequate protection provided for foreign investors, since the basic guarantees offered by the Russian Federation are unknown. In Article 6, the oblast is stated to have an obligation to ensure proper fulfillment of terms on which foreign investments were attracted. This obligation should be asserted more directly and forcefully and its nature clarified; for example, is it an obligation under international law, Russian Federation law, or only oblast law? Also, there seem to be no consequences to the oblast if it does not fulfill this obligation; for example, is the oblast subject to lawsuit by a foreign investor?

B. Prohibition of Performance Requirements

A domestic law aimed at attracting foreign investment should specifically state that no performance requirements are imposed on foreign investors. Thus, foreign investors will not be

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[6] Article 16 also contemplates such special privileges.

[7] It is not clear, however, whether, as a constitutional matter, the oblast can adopt liberalization measures and eliminate, in the territory of the oblast, some of the investment restrictions provided for in the law of the Russian Federation. If the oblast government has such powers, it should take this opportunity to do so.

required to export a certain percentage of output, give preferences for domestic sales, achieve a certain level of domestic content, transfer technology, or balance domestic sales with exports or foreign exchange earnings. If the foreign investor decides to make such commitments, for example, in a joint venture contract with a local partner, such a decision should be dictated by business considerations and not by obligations imposed by the law. In such a way, trade distortions are eliminated and fair competition is ensured in the market. To the extent that this is within the jurisdiction of the oblast, the law should clearly prohibit the imposition of any performance requirements.

C. Freedom of Transfer of Profits and Other Payments Relating to the Investment

Article 13 of the draft is not satisfactory in that the article covers free transfer of profits only. The guarantee should extend to the free transfer of all proceeds and payments relating to the foreign investment in the currency of the initial investment or other freely convertible currency. Thus, the guarantee would cover not only profits but also returns, including dividends and other distributions on account of an ownership interest, and interest; royalties and other payments deriving from contracts, licenses, franchises, concessions, and other similar grants of rights; repayment of loans; proceeds from liquidation or sale; payments for maintaining or developing the investment project; earnings of expatriate staff; compensation; and payments arising out of the settlement of disputes. The drafters also might wish to consider adding preferential treatment for domestic reinvestment to Article 13.

As a constitutional matter, the competence of the oblast administration to provide substantive guarantees to the freedom of transfer of profits and all other payments may be limited. In this regard, the reference to the law of the Russian Federation is understandable. The reference to the legislation of the oblast, however, makes this guarantee meaningless; such reference in essence allows the oblast government to adopt restrictions to the freedom of transfer of proceeds and payments. The draft should contain an unconditional commitment by the oblast government not to create any obstacles to the free transfer outside of the oblast of any proceeds relating to foreign investments and to facilitate such transfers within the limits of its competence.

The requirement that taxes be paid before transfers are allowed is incompatible with a guarantee that proceeds and payments relating to a foreign investment can be freely transferred. It is ambiguous even in the context of the provision as it is in the current draft. There must be other ways of enforcing the Russian and oblast tax laws. If, however, the provision is kept, it is suggested that the language be changed to "any non-disputed" taxes.

D. Expropriation and Compensation

Certainty as to real property ownership is a real concern among foreign investors.[8] The draft should contain a clear and explicit obligation by the oblast government not to expropriate,

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[8] *See* David Black, *So You Want to Invest in Russia? A Legislative Analysis of the Foreign Investment Climate in Russia,* 5 MINNESOTA JOURNAL OF GLOBAL TRADE 123, at 140 (1996).

either directly or indirectly through measures that amount in their consequences to expropriation or nationalization,[9] except for a public purpose, in a nondiscriminatory manner, in accordance with due process of law, and upon payment of prompt, adequate, and effective compensation.[10] Compensation should be equivalent to the fair market value[11] of the expropriated investment, be paid without delay,[12] include interest[13] from the date of expropriation, and be transferable outside of the oblast and of Russia at the prevailing market rate of exchange. A typical provision commonly found in other foreign investment legislation provides that:

> Investments shall not be nationalized or expropriated except for a public purpose and against prompt, adequate and effective compensation. Such compensation shall amount to the market value of the investment expropriated immediately before the expropriation or impending expropriation becomes public knowledge, and it shall be effectively realizable and freely transferable.

Although Articles 8 through 20 set out many of the obligations undertaken by the oblast that aim to create an environment conducive to foreign investment—through a series of incentives, guarantees, and procedures—these articles do not adequately address the issue of compensation. In fact, an investor must know what kind of compensation and what type of guarantee coverage will be provided: will it be eighty percent, ninety percent, or one hundred percent? The procedure, the criteria for, and the process of compensation should also be outlined. A typical provision setting out the compensation standard provides that: "compensation will be full and effective and payable in the currency of the origin host country. The amount of compensation will be transferred to the country of origin of the investor within a period of three months."

Furthermore, there should be specific assurances that the real property that the foreign investor's business rests upon will not revert back to the state in the event the business shuts

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[9] Some provisions to that effect are contained in Article 12 but need to be clarified and made more explicit. For example, expropriation should specifically be listed alongside nationalization. Similarly, in Article 11, "expropriation" should be added to the list of types of nationalization for the sake of clarity and completeness. The exception for nationalization "except for the decision of the authorized Federal bodies in conformity with the RF legislation" is very broad and greatly reduces the value of a guarantee against expropriation, as virtually any expropriation can be seen as being "in conformity with" the law.

[10] Courts should be empowered to nullify the effects of an illegal taking or nationalization.

[11] Alternatively, the standard of compensation could be the *greater* of the full market value of the investment *or* the commercial value to the investor, which may be greater than the market value due to synergy, for example.

[12] Article 12 refers to payment of compensation without "justified" delay. This notion is, like much of the law, well-intentioned and wisely included. However, merely including the provision without greater specificity invites confusion. A similar general comment applies to Article 15: the reason for suggesting that the oblast has "the right" to provide for accelerated depreciation, but no obligation, is not clear. Unless the oblast intends to provide for it, it is unclear why there is mention of the oblast's right to do so.

[13] The relevant interest rate should be a market rate of interest and not the interest rate of the Russian Federation. *See also* Article 30.

down for a period of time or even completely. This is an issue that may not be fully answered by the current Russian Federation law on foreign investment. If possible, a specific provision should be included dealing with the issue of whether the investor still owns the real property on which his or her enterprise rests in the event that it is closed.

Article 12 states that compensation for nationalization or confiscation will be calculated and processed in accordance with federal legislation.[14] Thus, here too, federal rather than local law seems to be determinative of the rights of foreign investors. It is significant, however, that, pursuant to Article 9, sources of compensation may include "real estate and other property" and "natural and raw material resources" owned by the Nizhny Novgorod oblast. To the extent that the relevant federal legislation does not provide for the same, this would represent for foreign investors in Nizhny Novgorod an important additional assurance. In Article 12, foreign investors "have the right for compensation of losses ... which they suffered from illegal actions of state authorities ... and also in case of infringing the implementation of investment project." Compensation is also provided for "improper fulfillment of the duties provided by legislation." It seems that the quoted language, to the extent it goes beyond illegal activities clearly specified as such in the legislation, is overbroad.

E. Dispute Settlement

Article 21 seems to require that all disputes relating to an expropriation and the payment of compensation be referred to the local courts and that all other disputes with government bodies be resolved through arbitration in the Arbitration court of Nizhny Novgorod. Foreign investors are generally reluctant to submit disputes to the local courts. Directing foreign investors to settle a dispute with a government agency in a local court is a significant disincentive. To guarantee to foreign investors that such disputes would be resolved fairly, the draft should provide for binding investor-state (local government) arbitration under internationally recognized rules and procedures.

Furthermore, Article 21 is inconsistent as to which disputes are to be decided by a court and which are to be decided by arbitration, especially in connection with disputes with governmental officials. Article 21 contemplates suits in court, but the draft should be clarified to clearly provide for judicial review, that is, the power of a court to overturn actions of the legislature or executive that are considered illegal under the draft or other laws of the oblast or Russian Federation. Also, the type of court is not specified: is it Russian, a court of the oblast, or a court of a neutral third-party forum? Presumably, the second paragraph of Article 21 is subject to the terms of the first paragraph. In other words, disputes may be settled in court only if there is no superseding Russian Federation legislative provision or international agreement.

Article 21 refers to the Russian law on foreign investment, making it difficult to assess the adequacy of this provision due to the inaccessibility of the latter for this analysis. According to the 1995 Annual Report of the *International Centre for the Settlement of Investment Disputes* ("ICSID"), the Russian Federation has signed but has not yet ratified the ICSID convention.

[14] It is assumed that the federal standard is also "instant and adequate compensation."

However, it would be in its interests to do so because more security is offered to a foreign investor when he or she knows that, should a dispute arise, the dispute will be settled via international arbitration and not through the local courts. In this respect, the Russian Federation should be urged to take the necessary steps to ratify the ICSID convention, and subsequently the draft can then benefit from a provision, commonly found in foreign investment legislation, which foresees that "in the absence of amicable arrangement or conciliation through diplomatic channels within three months of the date of its notification, the dispute shall be submitted to conciliation or arbitration of the International Centre for the Settlement of Investment Disputes (ICSID)."

F. Policy Concerns

The most important policy concern left unaddressed in the draft is the investor's fear of private corruption in the oblast. Many would-be investors in Russia may be dissuaded due to the strength of the Russian mafia and the control the mafia presently exerts over many foreign and domestic businesses in Russia. This being the case, assurances must be given in the draft against such corruption. Indeed, throughout the draft, assurances are made against "illegal acts" of government officials, but it is important that the legislation demonstrate how these assurances will actually be enforced.

Bribery and corruption of public officials is well-known in many developing countries. However, American investors are prohibited by the Foreign Corrupt Practices Act[15] from engaging in such activities. If bribery and political corruption are widespread in the oblast, American investors will be at a competitive disadvantage with respect to investors from other regions, such as western Europe.[16] Thus, given the existence of the Foreign Corrupt Practices Act, the existence of widespread bribery and corruption would tend to reduce American investment in the oblast.

III. Constitutional Issues

Nizhny Novgorod is an oblast, and, as such, its laws are subject to national legislation by the Russian Federation.[17] Ideally, Russian Federation law would be settled and subject to only minor alterations. As is frequently observed in the explanatory note, the various relevant Russian Federation laws are dismaying combinations of obsolete and current provisions. Moreover, Russian Federation law is likely to change in potentially significant ways, and it is likely to do so sooner rather than later. Foreign investment and involvement in domestic business is a particularly sensitive issue in a nation that has more than its share of political instability. Since the ideal situation does not exist, drafting useful oblast legislation is problematic.

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[15] 15 United States Code Section 78m(b) *et seq.*

[16] It is suggested that imposing "personal" responsibility on government officials should be limited to hard crimes, so as not to discourage governmental service.

[17] By comparison, for example, in Shenzehen, an enclave in China, the administrative and economic mechanism is sovereign and free from central Chinese government intervention.

Under the circumstances, it is somewhat easier to understand the lack of specificity in the draft. The supremacy of Russian Federation law and its presently disruptive state are the reasons for the lack of particularity in the draft. A surprising amount of the text is precatory; although general policy considerations may be commonly cited in oblast legislation, there is a large amount of text that is either devoted to non-legal matters or to language that is too general to be helpful or even serve a practical purpose. Most of such writing is clearly related to the aims of the law but is of little, if any, legal consequence. In fact, most of the second half of the law, beginning with Article 24, is so dependent upon Russian Federation law as to offer little of substance to a foreign investor.

At a minimum, the draft, or a covering explanation, should delineate the details of the existing Russian Federation law governing foreign investments in Nizhny Novgorod and the powers of the Oblast Legislative Assembly to supplement the federation law. At this time, this is apparently an impossible task because of the conflicting and obsolete nature of the federation laws governing foreign investment. In other words, the draft may be premature. What foreign investors seek is certainty: what are the rules governing their investment, who administers those rules, and how protected against arbitrary action are they likely to be? Unfortunately, with the uncertainty of the Russian Federation's laws regarding foreign investment, Nizhny Novgorod, as a sub-unit of the federation, is impotent to solve the problem by fiat of the oblast legislature. Nizhny Novgorod must, therefore, depend on the federation's legislature to resolve certain matters.

For example, most of Article 8 relates to various obligations "taken" by the oblast government. They are important issues but, treated in the future tense, are not the content of practical legislation. To the extent that there are exceptions—that is, notions expressed that should be contained in a law like this—they are so vague as to offer only the coldest of comfort. Thus, for example, the oblast promises that it will "compensate for losses" suffered by foreign investors.[18] The general concept that is expressed will be welcome to investors, but it contains nothing concrete or specific. Anyone offering legal advice to a prospective investor on the basis of this provision would be likely to counsel extreme caution. It is suggested that these obligations be made subject to international law if possible.

Article 8 contemplates legal measures taken by the oblast against "unfair competition," which presumably includes Western-style antitrust type laws. While a legal monopoly, such as the government's monopoly over the printing of money or the building of roads, is a true monopoly, the concept of a non-legal monopoly has always been problematic, and legal systems could be well-served to abolish this concept.[19] Typically, "monopoly power" or "economic power" is attributed to successful companies that grow and prosper due to innovation,

[18] Article 8(6). Here, the oblast agrees to compensate foreign investors for breaches by Russian participants in the investment activities. It is inappropriate for the oblast to guarantee the performance of Russian citizens. If the provision is kept, however, it should be amended to read "to *fully and promptly* compensate for losses ...."

[19] *See* MURRAY N. ROTHBARD, MAN, ECONOMY, AND STATE: A TREATISE ON ECONOMICS (3d. ed. 1966), at 604-15, discussing "The Illusion of Monopoly Price on the Unhampered Market," and HANS-HERMANN HOPPE, A THEORY OF SOCIALISM AND CAPITALISM: ECONOMICS, POLITICS, AND ETHICS (1989), section entitled "Fallacies of the Public Goods Theory and the Production of Security."

efficiencies, and satisfaction of customer demands. To punish firms for being "monopolistic" is to punish success and prospering. The oblast should not persecute successful companies but should instead encourage success to attract foreign investment. Furthermore, Article 8(1), concerning the creation of a "favorable" image in the region for foreign investment, is vague; with regard to this, the oblast could consider setting up a Web Site on the World-Wide Web to promote itself. Article 8(3) is unclear in meaning.

There are other examples of this approach in the draft. Article 10 simply lists a variety of means to encourage foreign investment. Even more, the article explicitly states that the oblast "may" undertake those measures, thereby only acting as a hollow promise. A foreign investor is well-advised to ignore this language for, if the oblast chooses not to pursue one of the listed measures, there is no recourse for the investor. This points up one of the graver aspects of this draft: it is often necessarily vague because of its relationship to Russian Federation law—one assumes it would supplement any similar federal measures in a concrete and specific way—but even when the oblast could offer detail, it fails to do so. The article does not contain any standards or procedures establishing how the benefits described therein will be bestowed, including protections against favoritism. The financial measures, such as provision of loans, surety, and so forth, should not be handled by the oblast but should be allowed to be serviced by firms on the market. Government involvement in such activities is unnecessary and can distort the market. The availability of private insurance is a better indicator of the true riskiness of investing in the oblast.

Article 22 addresses in general terms the types of legal structures that foreign investors may wish to use for their local organizations. Without a copy of the Russian Federation law on the subject, it is hard to know, but it seems that this must be largely duplicative. Moreover, it would be surprising if the Russian Federation law would defer to oblast law on this particular subject. Indeed, Article 23 states that these procedures are "defined by the RF legislation." Finally, a presumption of legality should be included to the effect that any type of investment not specifically prohibited by the draft is legal. Article 26 appears to contain a similar presumption but, if so, this should be clarified.

A. Filling the Gaps in the Law of the Russian Federation

The purpose of the draft, as correctly stated in the explanatory note, is to fill in the gaps in the current Russian Federation law on foreign investment. The draft cannot be comprehensive, since certain areas are regulated by the law of the Russian Federation and are not within the jurisdiction of the oblast. To avoid discrepancies and contradictions, the drafters have included in the text of the draft numerous references to the law of the Russian Federation. It is unnecessary to repeat the relevant provisions of the law of the Russian Federation in the draft. It is equally unnecessary to specify with respect to each provision of the draft that it applies in conformity with the law of the Russian Federation. It is clear that foreign investors should carry out business activities in the oblast in conformity with the law of the Russian Federation as it applies in the territory of the oblast. Furthermore, repetition of Russian law provisions or repeated references to such provisions create confusion in terms of their interpretation, which regulatory agency will implement and enforce such provisions, and at what level—the Russian Federation or the oblast.

The regulatory agency is the Oblast Administration of Nizhny Novgorod. The administration establishes procedures for the registration of foreign investors and the liquidation of enterprises. It also has a fairly open screening law, but its powers are limited because the Russian Federation authorities play a part in determining who should be given the right to invest. Denial of registration may be appealed against in a court of law. Reasons for refusal can only be given by the Russian Federal authority. Other than references to the "Oblast Administration"—without indicating its composition and functions—there is no mention of any agency or other government entity exclusively responsible for encouraging, promoting, and overseeing foreign investments on the territory of Nizhny Novgorod. Where do the prospective investors apply? Who will control foreign investments? It is imperative that such an agency or a government organization to administer the draft be foreseen. Further legislative involvement is time-consuming and political and should, therefore, be limited. Of course, if there is already such an organization established by the Russian Federation, it would probably have the jurisdiction to oversee foreign investment in the oblast; however, it is unclear if it has the explicit mandate to do so. In addition, what seems to be lacking in the draft is an enforceable framework of laws and institutions that define and ensure both the rights and duties of all players in the economy of the oblast. For example, there are no laws dealing with economic crimes, such as investment scams, money laundering, counterfeiting, and bribery.

Finally, the jurisdiction and the powers of the oblast government in the area of regulating foreign investment should be explicitly defined in the draft. The role of the oblast government in the implementation and enforcement of the rights and obligations of foreign investors should be clearly stated. The draft attempts to do that in Part 2. It is not, however, clear what guarantees to foreign investors are provided by the oblast law in addition to the guarantees and protections provided to them by the law of the Russian Federation.

B. Overregulation

An attempt to draft a foreign investment law that would be a comprehensive code of conduct of foreign investors is harmful. Once subjected to national treatment, the foreign investor will need to look at the relevant provisions of Russian law applicable *erga omnes* to find out how the type of activities in question are regulated and what his or her rights and obligations are. Any attempt to spell out the rights of foreign investors and the types of business activities available to them will inevitably lead to restricting those rights and activities; it is impossible to summarize Russian law—or any domestic law—in a single foreign investment statute. The objective of a foreign investment law is to lay down the basic principles, such as national and MFN treatment, and to provide certain specific guarantees to foreign investors. For the rest, domestic law should apply to foreign investors as it applies to nationals.

One illustration is provided by Article 3, specifying that foreign investors "independently determine directions, forms and volumes of investments, conduct on the territory of the oblast" and other activities that are not directly prohibited by Russian law. There is hardly any doubt that foreign investors should carry out their activities in the oblast in accordance with federal and local law and that they can engage in any activities not prohibited by federal and local law. Article 3, however, raises the issue whether foreign investors can "determine independently"

other aspects of their activities, in addition to the "directions, forms and volumes of investment"; if so, why are only "directions, forms and volumes of investment" specifically referred to?

C. Specific Commitments by the Oblast Government

One way to encourage foreign investment and to facilitate foreign investors doing business in the oblast would be to create an office to assist foreign investors in deriving the full benefits of the foreign investment climate in the oblast in connection with their investment and related activities. Such an office could serve as the coordinator within the oblast administration and the problem solver for investors experiencing difficulties with registration, licensing, access to utilities, and regulatory and other matters. The office could also provide information on current national and local business and investment regulations, including licensing and registration procedures, taxation, labor conditions, accounting standards and access to credit. The office could notify investors of proposed regulatory or legal changes affecting them or regulatory changes already entered into force. The office could also facilitate the resolution of disputes. In addition, the office can identify and disseminate information on investment projects and their sources of finance that would facilitate attracting investors. The office could also assist investors experiencing difficulties with repatriating profits and obtaining foreign exchange.

The United States government and a number of western European governments have sought the creation of such offices in various Central and East European countries in their bilateral treaties for the protection and encouragement of investment. Foreign investors will be encouraged by the creation of such a "one stop shop," where they can obtain all necessary information and assistance in connection with their investment.

IV. Enforcement

There is a serious concern about whether the substantive provisions of the draft would be enforceable. In view of the extensive federal regulation of foreign investment activity in Russia, does the oblast have the legal authority to grant additional rights and privileges to foreign investors? Specifically, it is noted that the draft guarantees foreign investors greater latitude in the types of activities they can pursue and also purports to grant foreign investors access to the courts. To the extent these topics are already regulated by federal law, which is understood to be supreme, the oblast draft would appear to be invalid. If the oblast indeed has the authority to legislate in this manner, then the source of that authority ought to be specified.

It is recognized that the drafters attempted to deal with this issue by including language throughout the draft to the effect that rights conferred by the oblast are valid only to the extent they do not conflict with federal law, by specifying that foreign investors may undertake any activity not prohibited by federal law, and further by stating that other existing federal legislation will remain in effect. However, relatively few foreign investors possess the expertise necessary to determine whether rights or privileges granted pursuant to the draft would, in fact, conflict with federal laws or, more fundamentally, whether an oblast has the authority to fill gaps in federal legislation in this manner. Foreign investors often need to be convinced that the legal environment in which they will be operating is simple and stable. By enacting a statute as a

supplement to federal law, the oblast would be adding an additional layer of complexity to the already confusing array of laws and regulations governing foreign investment and business activities in the Russian Federation. As a result, the draft could, in fact, be somewhat counter-productive.

Moreover, with regard to topics such as investment registration, customs, export, import, accountancy, repatriation of profits and guarantees against expropriation, confiscation, and so forth, the draft appears duplicative of existing federal law. Indeed, the draft specifically refers to "existing legislation" and states that such existing legislation shall remain in effect. There seems to be little value in acknowledging and referring to such other existing legislation absent reason to question its validity. The draft could be shortened and simplified considerably if specific references to existing legislation were eliminated.

In short, the oblast needs to reconsider whether to enact actual legislation respecting foreign investment. To the extent the draft is duplicative of existing legislation, the oblast should refrain from promulgating legislation respecting the same topic. To the extent the draft is inconsistent with existing legislation, the draft is likely invalid. Consequently, it is suggested that the oblast could better achieve its stated goals of attracting foreign investment and eliminating uncertainty in the law by issuing a proclamation of official oblast policy that includes the substantive provisions of the draft, such as the investment agreement. This course of action would send a strong message to foreign investors that the oblast views foreign investment favorably, that the government will cooperate with investors and champion their cause, and that the government will grant investors incentives and will guarantee stability in legal regulation.

As noted above, it is not always clear that the various oblast guarantees in the draft offer real additional protections or benefits over and above what federal legislation already provides. For example, Article 11 begins by stipulating that foreign investment cannot be nationalized or confiscated "except for the decision of the authorized Federal bodies in conformity with the RF legislation." Much turns, then, on the content of the relevant federal legislation. If federal legislation generally prohibits nationalization or confiscation at the federal level, then Article 11 provides something of value, at least in theory, namely, an assurance that nationalization and confiscation will not occur at the oblast level either. On the other hand, if the federal legislation does not generally prohibit nationalization or confiscation, then, for reasons that follow, the oblast guarantee may add little of value.

Article 11 also states that the oblast will protect the rights of foreign investors vis-à-vis the federal government by contesting acts by the federal government "violating ... the rights or legal interests of foreign investors." The resulting decision of the federal government[20] can be "appealed to court." A foreign investor would properly be concerned about the ability of the oblast government to challenge or reverse any acts of the federal government. The draft is very vague about the process through which the oblast would go about trying to protect the rights and interests of foreign investors on its territory. It is also unclear how an appeal would be submitted; which court would hear the appeal, whether an oblast court or a national court; or how likely it is

[20] It is not clear which branch or department would make such a decision.

that such an appeal might ultimately be successful. In addition, the procedure is not stated: is it governed by extant civil rules or are separate rules to be devised for foreign investors? What remedies are available? How will they be enforced? In short, it is not clear that Article 11's guarantee "from illegal actions of governmental bodies" has much bite.[21]

V. Definitions

A. Definition of Foreign Investor and Foreign Investment

One of the purposes of the draft, as evidenced in the explanatory note, is to be as comprehensive as possible. However, it is extremely difficult to draft a comprehensive definition of *investment* and *investor* by enumeration. The definition of *foreign investment* could contain an illustrative list of what is covered by the definition but should also contain a general part that would make it clear that (1) the list is not exhaustive and (2) the definition is open and inclusive rather than exclusive. The current definition in Article 2 does not include certain rights, such as mortgages and pledges, claims to money or to performance, and contract rights, while intellectual property rights are qualified. In addition, the definition of *foreign investor* is unclear about the relationship to registration requirements, and the definition of *foreign investment* omits personnel and management contracts as possible forms of contribution to equity.

The approach used in bilateral investment treaties to draft a comprehensive definition of *foreign investment* is to define foreign investment as "every kind of investment" in a certain territory owned and controlled directly or indirectly by foreign nationals and then to give examples of the types of such investment. Such a definition, while defining *foreign investment* by "investment," is comprehensive and inclusive. It is important that these definitions be defined clearly because they serve as an important first step of admissibility of all potential investors and investments.

B. Foreign Investment and Foreign Investment Activities

There should be no distinction between foreign investment and foreign investment activities. Such a distinction creates confusion throughout the draft. Creating two separate regimes, one for foreign investment and another for activities relating to such investment, is dangerously ambiguous. As defined in Article 2, *foreign investment activities* cover the making or allocation of an investment and the operation or management of an investment. This is precisely what national treatment and MFN treatment should cover. The treatment of foreign investors and foreign investment includes all "activities" of foreign investors relating to the investment. Separating "investment" and "activities" makes no sense at all; by creating two separate regimes, such a distinction creates new restrictions, uncertainty, and ambiguity.

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[21] Here, one might argue that the oblast should be doing other things within the realm of its powers and resources, for example, the oblast could be an advocate for foreign investment in the courts as well as in the Russian Federation legislature.

Once a comprehensive and inclusive definition of foreign investment is drafted, it will be clearer that "foreign investment activities" are included in such a definition. The types of foreign investment activities described in Article 4—joint ventures, "complete" ownership, establishment of subsidiaries, acquisition of existing companies, franchising, leasing, and so forth—are covered by a comprehensive definition of foreign investment.[22]

C. Objects of Foreign Investment Activities

Article 5 is harmful to the stated objective of the draft, namely, attracting foreign investment, and has no other effect than to impose additional restrictions on foreign investment. Even if the purpose of Article 5 is to impose additional restrictions on foreign investment, Article 5 should nevertheless be redrafted. The article should specifically state that, in addition to the restrictions imposed by the law of the Russian Federation on foreign investment, the draft restricts foreign investment in certain specifically enumerated sectors.[23] This will not, of course, be conducive to attracting foreign investment. However, the current approach is even less attractive. By designating areas, the so-called "objects of priority," where foreign investment is somehow encouraged or less restricted, the draft provides for exceptions from a general principle of restricting foreign investment instead of providing for narrowly defined exceptions from a general principle of freedom of investment.

If the draft intends to provide restrictions in addition to those provided under the law of the Russian Federation, the draft should (1) specifically list such exemptions from national treatment, (2) define them as narrowly as possible, and (3) contain an obligation not to expand the list by adding new exemptions and not to broaden the scope of existing ones. Otherwise, the draft will serve to deter foreign investors from doing business in the oblast instead of attracting investors. If, however, the objective of the draft is to attract foreign investment to the oblast, the draft should provide for no restrictions on foreign investment in addition to those already existing under the law of the Russian Federation. The law of the Russian Federation provides for certain exemptions from national treatment. It will be desirable for the draft not to add to those exemptions and to specifically state that no exemptions from national treatment, other than those provided for in the law of the Russian Federation, will apply to foreign investment in the territory of the oblast. Any additional restrictions imposed by the oblast will divert investors to other regions of the Russian Federation where only the restrictions of the Russian Federation law apply.

Article 5 is troubling in that it provides the oblast government with the right to approve sectors and geographic areas "which have priority for foreign investments." Thus, there will be no transparency, stability, and predictability. No criteria are specified, thereby opening the door to arbitrariness. At the same time, the criteria for prohibiting foreign investment in certain sectors

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[22] With regard to organization of the draft, Article 4 and Article 22 seem to cover much of the same ground and ought perhaps to be consolidated. Similarly, Article 5 and Article 26 cover much of the same subject matter.

[23] The draft could provide that no further prohibitions will be enacted. The draft could at least make it clear that any existing foreign investments are exempt from changes in the law that render that type of investment unlawful. Article 14 contemplates only a three-year stabilization.

are extremely elastic: an investment is prohibited if it causes or may cause damage to the rights of citizens, legal entities, the oblast, and the Russian Federation or if the investment violates sanitary-hygienic, ecological, technical, or other standards. There can hardly be anything more arbitrary than such broadly formulated criteria: anything can be prohibited under this provision. There is, therefore, no need for such a provision in the draft. National treatment means that Russian and oblast law applies to foreign investors as it applies to Russian, that is, local, persons. Thus, sanitary-hygienic, ecological, technical, or other standards apply to foreign investors as they apply to nationals and are enforced in the same way. A foreign investor breaching the law of Russia or causing damage to rights and interests of nationals, the oblast, or the federation should be treated the same way as a Russian party would in like circumstances. In other words, the foreign investor cannot do what the Russian cannot do; if the foreign investor breaches Russian law, he or she will be sanctioned as the Russian investor would be. The sanction will not necessarily amount to a prohibition to make the investment; the foreign investor may, for instance, be required to pay damages or fines to comply with the standard breached.

D. Subjects of Foreign Investment Activities

Article 3 is problematic for it attempts to regulate who the local counterparts of foreign investors should be. Such an attempt is unnecessary and is by definition restrictive. There is absolutely no reason for any domestic law to restrict foreign investors in terms of who their local partners can be. Again, once the concept of national treatment is understood and implemented, the absurdity of a provision on "participants" in foreign investment activities becomes apparent.[24]

The provision in Article 3 stipulating that "[t]he basis for foreign investment activities ... is [an] investment agreement" may be an unnecessary restriction that foreign investors will find puzzling. Any relationship between a foreign investor and his or her Russian, or oblast, counterpart has to be based on an investment agreement. The provision virtually requires that any transaction, however it is otherwise regulated under Russian law, be carried out on the basis of an investment agreement if one party to the transaction is a foreign investor. Such a rule in itself flies in the fact of national treatment.

Furthermore, any of the various types of "investment activities," *e.g.,* leasing or franchising, must be based on an investment agreement, not on a franchising or a leasing contract. It is thus unclear to what extent Russian law regulating franchising or leasing contracts would apply to an investment agreement on which the foreign investment activity of franchising or leasing is based. This Article 3 provision would thus create two levels of rules: rules applying to transactions between Russian parties and rules applying to similar transactions between Russian parties and foreign investors. This is a denial of national treatment.

[24] It is unclear whether or not participants in foreign investment, who may be Russian citizens, could also be oblast citizens.

On the other hand, the investment agreement[25] provided for in Article 3 may be an excellent idea. This document would stipulate the rights, duties, and responsibilities of the parties involved. Presumably, the special incentives provided for in later articles would be incorporated into this document which, pursuant to Article 19,[26] the oblast governor would sign. Providing foreign investors such written guarantees gives investors a sense of security against unforeseen changes in the legal environment. One idea the drafters might consider would be for the oblast to commit to rendering a legal opinion stating that the investment agreement is legal and enforceable and that nothing contained therein contradicts Russian Federation legislation. The legal opinion could be appended to the investment agreement. Such an opinion would help alleviate foreign investors' concerns about whether the rights and privileges stated in the agreement are valid and enforceable.

In conclusion, therefore, if the draft is to attract foreign investment to the Nizhny Novgorod oblast, the draft should abandon the concepts of "foreign investment activities," its "subjects," and its "objects." The draft should: (1) contain comprehensive definitions of *foreign investor* and *foreign investment,* (2) guarantee national treatment and MFN treatment with no restrictions other than those already imposed by the law of the Russian Federation, (3) provide for guarantees, such as the prohibition of performance requirements and guarantees relating to expropriation and transfers, (4) facilitate the activities of foreign investors by creating the appropriate institutional mechanisms and guarantees, and (5) to the extent possible, provide foreign investors with an impartial third party mechanism for settlement of disputes with the oblast government.

VI. Procedural Issues

Although the draft sets out certain procedural issues, it does not delineate who will do what and what their mandate will be. Furthermore, at times the law is so cumbersome with unnecessary detail and incentives void of any substantive meaning that it reads more like a regulation than a law. With regard to detail, for example, in Article 9—which concerns funds for the oblast's "state guarantees security"—the sources are unnecessary because the investor is only interested in the fact that there is a guarantee and not on the government's financial sources for granting it. In addition, this article is unclear and seems to be insufficiently integrated with, and related to, the rest of the draft. It is not clear whether these funds are for paying damages resulting from expropriations of property and the like. If that is the case, provision should be made to place such funds with a neutral third-party escrow agent located outside the Russian Federation's jurisdiction. Furthermore, Article 9 not only unnecessarily ties the hands of the oblast if, for unexpected reasons, changes are needed but also offers little to foreign investors except an expression of support.

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[25] It is not clear whether an investment agreement is different from a concession agreement, *see* Article 3, fourth paragraph. Furthermore, *investment agreement* should be clearly defined as a listed, defined term. Its status under international law should be clarified, with a view towards making it clear that any obligations or guarantees undertaken by the oblast in the draft are to be considered binding under international law, to the extent permissible under both Russian Federation law and international law.

[26] It is not clear what the "authorized government body" in Article 19 is.

In general, lack of procedural specificity is a problem throughout the draft law. Article 16, which provides for additional benefits for foreign investment projects of "particular economic or social importance" is a good example. Although this appears to be an important step in the right direction, there is concern whether these unenumerated "additional tax privileges and guarantees" actually offer investors something valuable. Article 16 is very vague about the process and criteria through which foreign investors may receive such additional benefits. Interested parties are asked generally to submit a "written application ... to the oblast Administration." The application is then assessed by "authorized State bodies" or by "independent expert (consulting) institutions." Who these state bodies or independent experts are is not at all clear. There is no further discussion as to who decides what projects are eligible, according to what standards, what the terms of the exemption or postponement are, who decides which one applies, and so forth. Article 17 addresses some of the criteria to be used but raises more questions than it answers. Foreign investors—who are often worried about hidden transaction costs in the form of "unofficial" governmental fees or payments—would probably take Article 16's incentives more seriously if the article specified the relevant application, selection, and appeals procedures more clearly. A final point regarding Article 16 is whether a Russian participant is always required. Assuming it is not, the phrase "information on the Russian participant" should probably be edited to avoid confusion.

VII. Property Rights

Promulgating a pro-foreign investment law that provides for government guarantees that property rights will be respected can play an important role in attracting foreign investment. However, as investors are all too aware, even a pro-investment law may be changed at a later time by the legislature due to the government's legislative sovereignty. A new government may desire to nationalize certain industries, for example. Thus, the ability of the Russian Federation or of the oblast to promulgate new laws that might override property rights previously guaranteed to investors tends to reduce the attractiveness of any government guarantees that are made. Especially for a developing economy such as Russia and its component units, such guarantees should be made more effective by reducing the chance that the laws will change to investors' detriment.

One way to increase the likelihood that such a guarantee, once granted, will be respected by future governments is to implement a constitutionally limited government, with an independent judiciary having the power of judicial review. Another way is to make the guarantees binding under international law, since states are often reluctant to be seen as clearly violating international law. An investment agreement executed between the host state and investor accordingly may be "internationalized," so that the state's obligations contained therein are binding under international law. For example, the agreement may contain both an international arbitration clause, which grants jurisdiction to a neutral third party, such as the International Center for the Settlement of Investment Disputes, and a stabilization clause. A stabilization clause provides that the law in force in the state on a given date is the relevant law for purposes of interpreting the investment agreement, regardless of future legislation. This effectively freezes the legal regime in place on a certain date so that any future changes in law contrary to the state's guarantees are without effect, at least under international law. Since it is

understood that the oblast is not a state under international law but is, instead, a political subdivision of the Russian Federation, the cooperation of the Russian Federation would appear to be necessary in order to properly provide for any internationalization of agreements. Likewise, any constitutional changes in favor of limited government and a free-market economy would presumably require appropriate authorization from the Russian Federation.

A Statement of Principles in Article 1 should clearly indicate that the oblast recognizes the importance and sanctity of private property and that the purpose of the draft is to protect the private property rights of foreign investors. Such a statement may be useful in persuading investors that the oblast is serious in its commitment to protecting and respecting investors' property rights. This statement would also increase the chance that the draft, in cases of ambiguity, would be interpreted in favor of investors' property rights. Furthermore, it is often unclear whether contractual rights are considered to be property rights on an equal footing with other types of property rights. The draft should clearly provide that "property" and "property rights" include immovables and movables, corporeals and incorporeals, intellectual property rights, and contract rights.

Article 14 begins by generally guaranteeing protection of most kinds of foreign investment activities, "regardless of the types of property," and prohibiting certain types of legislation. In the second paragraph, however, there is introduced the possibility of "changes in legal norms," which will be announced to foreign investors "in advance ... through publications in mass media and on TV." The third paragraph states that in the event the oblast passes legislation that affects the legal rights of foreign investors, such investors will be given three-years notice. Alternatively, the need for a "grandfather" clause is understood, but this is not necessarily the best way to achieve the desired effect. Thus, Article 14 appears to attempt to "stabilize" the legal regime so that laws cannot be enacted to the detriment of an investment. However, the stabilization lasts only three years, far too short a time for investors who often calculate the feasibility of an investment on the scale of decades.

The first and third paragraphs of Article 14 are clearly inconsistent and, arguably, neither approach is correct; the legislation needs to address changes in law in terms of normal regulations versus regulatory takings. Article 14 should clarify that it applies only to pre-existing investment, which necessitates specification as to precisely when an investment is considered to have been made.

On the other hand, the guarantee that changes to the foreign investment law would not take effect for at least three years after being enacted, is impressive. This grace period could give foreign investors an additional feeling of security. It is noted that the law is silent regarding how such changes to the law would be brought about in the first instance. In order to eliminate uncertainty, the drafters should consider stating how such changes would be made and by whom. Also, if permissible under governing law, the drafters might wish to consider including a provision to the effect that no changes will be made absent a super-majority vote of the legislature or another similar restriction on the government's ability to change the law. Such a concession would undoubtedly be viewed as a serious commitment on the part of the oblast to promote and support foreign investment.

VIII. Promotion of Free Market Policies

The draft is obviously intended to promote foreign investment and market policies in general. With suitable modifications, it may well succeed in doing so. It is, however, suggested that the draft take into account long-term economic growth and social and political stability. There are two specific concerns in this regard.

First, the drafters are urged, either in revising or implementing the law, to be cautious about the extent to which Nizhny Novgorod's land or natural resources are offered to foreign investors as enticements or guarantees.[27] History throughout the developing world indicates that insensitivity to issues of sovereignty and nationalism, particularly with respect to precious or symbolic minerals and resources, can over time give rise to powerful xenophobic reactions on the part of the local population. Such reactions, especially in countries without long-standing democratic traditions, can be economically and politically destabilizing. It is not suggested that real estate or natural resources should never be offered as security to foreigners—indeed, an oblast such as Nizhny Novgorod may have little choice if it wishes to attract foreign investment—but the point is that the long view of things should be adopted to the extent possible.

Second, it is recommended that provisions specifically aimed at ensuring long-term benefits for Nizhny Novgorod be included, such as:

- Sharing of Technology and Technical Expertise. Many developing country investment codes provide incentives for foreign investment projects that will "assist in permanently implanting" new technology in the host country. Thus, under the Sri Lanka Code, proposals for private investment are more likely to be accepted to the extent that they foster local "technology producing capacity."[28]

- Employee Training Requirements. Under the Liberian Code, foreign investors are obliged "to employ Liberian manpower and to select and train Liberians on a systematic basis in skills required at all levels in the Operation of the Approved Investment Project."[29]

- Local Capital Participation. Many investment laws provide inducements or requirements for joint ventures with local investors. Under the Sri Lanka Code, the

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[27] Article 4, Article 9, and Article 39. In Article 43, the Russian Federation regulations regarding mining natural resources should be clarified. The present policy of the Russian Federation in this area is difficult to understand and may be the greatest single obstacle to long-term foreign investment in the country. Article 39 is unclear whether property that may be acquired includes immovables such as *land*; even though real property is mentioned, land seems to be excluded by implication of not being listed along with less-important types of property. If so, this should be made clear. Article 43 also implies that land can be owned by foreign investors.

[28] *See* Government of Sri Lanka (Ceylon): Policy on Private Foreign Investment in Appendix D, pages 74 and 75.

[29] *See* An Act Amending the Investment Incentive Code of the Republic of Liberia in Appendix E, page 68, Section 7(1)(b).

general rule for foreign investment in the private sector "will be that local collaborators should hold the greater part of the shares and retain effective control."[30]

- Development of Underdeveloped Areas. Some investment codes provide incentives for foreign investment in less industrialized or less developed parts of the host country.

While these suggestions run counter to the unfettered free market policies currently in vogue, they may be preferable from the point of view of *long-term* efficiency and modernization.

IX. Insurance

The draft purports to have Nizhny Novgorod establish a foreign investment insurance scheme; it is doubtful, however, that any foreign investor would be willing to rely on one oblast's purported insurance against expropriation. Article 20 does not address what the insurance is supposed to cover, what premiums will be required of the foreign investor, or what role the oblast will play. Investors are unlikely to take such insurance seriously when offered by the place receiving the investment because the continuity, dependability, reliability, solvency, and integrity of the insurance is changeable at the whim of the local legislature; foreign investors are likely to take such insurance seriously only when it is offered by their own country or multilaterally, for example, the World Bank's MIGA. Obviously, insurance of the type provided by the United States Overseas Private Investment Corporation, such as against civil disturbance, may be desirable but may require some funding by the oblast.[31]

X. Bookkeeping and Accountancy

Article 30 states that, for the purpose of balance estimation and bookkeeping, the amount of investment is tied to the exchange rate at the Central Bank of the Russian Federation. Although the article does not state exactly how important such an accounting actually is, it is quite possible that the instability of the ruble may hurt the foreign investor in this process. Possibly, this accounting should be based at least temporarily on the dollar until the ruble becomes more stable.

XI. Drafting Issues

From a drafting viewpoint, the draft is too lengthy a document, and it is not always clear and well-organized. In this respect, the draft's complexity neither encourages foreign investors nor promotes foreign investments. In fact, the detail provided in many articles is strictly regulatory information that, at times, is more suitable for a regulation than for a foreign investment law. Succinct articles with one theme are preferable to a cross-reference of subjects

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[30] *See* Appendix D, p.74.

[31] *See* Paul E. Comeaux and N. Stephan Kinsella, *Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance*, 15 NEW YORK LAW SCHOOL JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW 1, in Appendix F.

addressed within one given article. Clarity is critical in all legislation but especially so in a foreign investment law, which does not usually benefit from abundant judicial interpretations of its provisions rendered by national courts. After all, in the foreign investment arena, if a law is poorly understood, it will simply not serve to attract foreign investment and, thus, its *raison d'être* will cease.[32]

Because some sections of the draft are ambiguous or seemingly inconsistent, they may have a discouraging effect on potential investors.[33] For example, it is unclear what *inexpedient* means in Article 18. Furthermore, what protection do investors have against the administrative body acting arbitrarily? Article 27 is unclear as to areas such as foreign trade zones, where the products are brought in for handling and processing with the ultimate objective of sending them back overseas.

[32] In this respect, the WORLD BANK GUIDELINES, in Appendix B, could be of assistance in ameliorating the draft's style as well as its content.

[33] *See* comments on Article 14 above.

Appendix A

Biographical Statements of Experts Assessing the Draft Law

Biographical Statements of Experts Assessing the Draft Law

Stanimir A. Alexandrov

Stanimir A. Alexandrov is Foreign Counsel in the Washington, D.C., office of Powell, Goldstein, Frazer & Murphy. His practice primarily involves international business transactions, trade and investment policy, international arbitration, and other forms of international dispute settlement. He also has experience in the law of the countries of Eastern Europe and in European Community law.

Prior to joining Powell, Goldstein, Frazer & Murphy, Mr. Alexandrov was Vice Minister of Foreign Affairs of Bulgaria, where he was in charge of Bulgaria's relations with the European Union, the United Nations, NATO, and other international organizations, as well as of the Legal Office. Prior to that, he was Deputy Chief of Mission of the Embassy of Bulgaria in Washington, D.C., where his duties included negotiating trade and investment agreements, agreements with international financial institutions, such as the World Bank and the IMF, and arranging for technical assistance projects. Earlier, Mr. Alexandrov also worked on United Nations legal matters in New York.

Mr. Alexandrov is also Senior Fellow at the International Rule of Law Institute of the George Washington University in Washington, D.C. He has taught courses on international public law and European Community law in Bulgaria and lectured in the United States on doing business in Eastern Europe.

Emmanuel Opoku Awuku

Emmanuel Awuku received his Master of Arts in Jurisprudence at Voronezh State University in Russia and his Master of Laws at the School of Oriental and African Studies, University of London. He is an independent legal consultant and is currently researching into matters relating to international trade and the environment and working in conjunction with the Foundation for International Environmental Law and Development. Mr. Awuku's publications include *How do the Results of the Uruguay Round Affect the North-South Trade?*, JOURNAL OF WORLD TRADE, 1994, and *A Trans-Regional Model of North-South Trade: The Lomé Convention*, HAGUE YEARBOOK OF INTERNATIONAL LAW, 1995.

Amy L. Chua

Amy L. Chua is an Associate Professor at Duke University School of Law. Prior to Duke, she spent five years as an associate at Cleary, Gottlieb, Steen & Hamilton in New York City working on privatization in Mexico and numerous securities transactions throughout Asia and Europe. Ms. Chua graduated magna cum laude from Harvard College in 1984 with a degree in Economics and went on to graduate cum laude from Harvard Law School in 1987. One of her publications is *The Privatization-Nationalization Cycle: The Link Between Markets and Ethnicity in Developing Countries* in the COLUMBIA LAW REVIEW.

William M. Doyle

William Doyle received his Juris Doctor from the University of Arkansas School of Law and also studied international commercial transactions and the law of the European Union at Cambridge University and Russian language, history, and literature at Kazakstan University. He is currently with the Elrod Law Firm in Siloam Springs, Arkansas. Mr. Doyle is the author of the forthcoming *Unlocking the Russian Door: Analysis of Russia's Economic Transformation and the Barriers Which Face Foreign Investment.*

Athena Debbie Efraim

Athena Debbie Efraim practices law with Efraim, Dourte & Associés in Montreal, Canada. During her stay in Washington in 1990, she was employed at the legal department of the Multilateral Investment Guarantee Agency (MIGA) of the World Bank, where she was part of a team responsible for providing legal assessments on the adequacy of foreign investment laws of several countries eligible for MIGA guarantees. She has an extensive academic background in international law, holding several university degrees and specialized diplomas. Currently working on her doctorate at the University of Montreal, she has researched and written on the protection of foreign investments. She holds an outstanding graduate award from the Washington College of Law of The American University, where she also obtained her Master of Laws in International Legal Studies.

David Gordon

David Gordon is an attorney practicing in Chicago. He is the author of a number of articles relating to foreign investment and privatization in Eastern Europe. His review of *The Polish Foreign Investment Law of 1990* was the first major article to appear on that law; his latest article, *Privatization in Eastern Europe: The Polish Experience,* appeared as the lead article in the 25th anniversary issue of LAW AND PUBLIC POLICY IN INTERNATIONAL BUSINESS. Mr. Gordon has served as a commentator on proposed East European legislation for the American Bar Association.

Mr. Gordon's career has been spent in both public and private practice. While in private practice, he focused on corporate and securities as well as on international law. Although his expertise is Eastern Europe, he has concluded transactions in Central and South America as well as the Pacific Rim. Since joining the United States Small Business Administration in 1991, he has worked in a variety of fields, concentrating since 1993 on the areas of commercial finance and government contracting.

Willis W. Jourdin, Jr.

Mr. Jourdin received both his undergraduate and law degrees from Stanford University. He served as a law clerk in the United States Court of Appeals for the Ninth Circuit from 1955 to 1957. Mr. Jourdin then worked as an attorney for Kaiser Aluminum & Chemical Corporation from 1957 to 1960. He was subsequently employed by the United States Agency for

International Development (USAID) from 1960 to 1963 and from 1965 to 1971. Between 1963 and 1965, he served as legal advisor for the United States Special Mission to Tunisia for Economic and Technical Cooperation in Tunis. He then took the position of Director for Claims and Director for Contract Administration and Construction Insurance for the United States Overseas Private Investment Corporation (OPIC) from 1971 to 1980. In 1980, he became Deputy Director of the International Law Institute. Currently, he is the Director of the International Negotiation Center, a position he has held since 1988.

N. Stephan Kinsella

Stephan Kinsella is a member of the Intellectual Property and High Tech Department of Schnader Harrison Segal & Lewis. He is also a member of the Firm's Internet Law and Computer Networking Practice Group. Previously, he practiced in the Energy Department and International Law Practice Group of the Houston law firm Jackson & Walker. Mr. Kinsella graduated from Louisiana State University with a Master of Science and a Bachelor of Science in electrical engineering and received his Juris Doctor from the Louisiana State University Law Center. He also received a Master of Laws in international business law from the University of London, where he studied at King's College, London, and the London School of Economics.

Mr. Kinsella is the author of numerous publications about common-law, civil-law, federal law, and international law topics. He is co-author of PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW: LEGAL ASPECTS OF POLITICAL RISK, forthcoming from Oceana in late 1996. His articles include *Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance,* published in the NEW YORK LAW SCHOOL JOURNAL OF INTERNATIONAL & COMPARATIVE LAW, and *A Civil Law to Common Law Dictionary,* published in the LOUISIANA LAW REVIEW.

Alexander Y. Loshilov

Alexander Y. Loshilov is admitted to practice law in Pennsylvania and is currently an Associate with Kirkpatrick & Lockhart, LLP. He concentrates on business law, taxation, and international transactions. Mr. Loshilov was born in the former Soviet Union, where he graduated from the Philological Faculty of one of the oldest Russian universities. He also completed two and a half years of legal studies in Russia. Mr. Loshilov worked as a correspondent and editor for a Russian newspaper, and he also worked for various business enterprises both in Russia and in the West. Mr. Loshilov received his Juris Doctor degree from the University of South Carolina School of Law in 1995 and has been with Kirkpatrick & Lockhart, LLP, since that time.

Brian S. Roman

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Attn: Mr. John C. Knechtle
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Explanatory note
to the Draft of Law

"On foreign investment activities in Nizhny Novgorod oblast of Russia"

On instructions given by the Legislative Assembly of the N.Novgorod oblast and in conformity with the normative work Plan for the year of 1996, the consulting company "Industrial Consulting Group, Ltd." and the Nizhny Novgorod oblast Committee on International and Inter-regional relations have developed the Draft of Law **"On foreign investment activities in the Nizhny Novgorod oblast of Russia".**

While working on the above mentioned Draft of Law we proceeded from the idea that foreign investments are needed both for Russia and N.Novgorod oblast - one of its subjects. That is why the main objective was to develop the Draft at most extent attractive for foreign investors without contradicting to Federal legislation and restricting the interests of oblast as well as the interests of its enterprises and citizens.

Foreign experience shows that the most intensive flow of foreign investments comes to the countries with:
- stable political and economic situation,
- convertibility and stable rate of national currency,
- taxation favorable for the foreign investment and customs regulations,
- reliable governmental guarantees.

Thus, for example, American investors proceed from the norms of profit when investing in developed countries (West Europe, Canada, Japan) of 12-15% (approximately the same norm of profit is in the USA). For the developing countries this figure increases up to 18%. According to the calculations of the American businessmen, the norm of profit in Russia due to the high risk level must be at least 25%.

Thus, when making a decision on investment in Russia in general and in Nizhny Novgorod oblast in particular, foreign investors have the right to count on more favorable conditions than they would be given in other countries (or other subjects of the Russian Federation). Hence, in case the N. Novgorod oblast is interested in attracting foreign investments to its territory, then one may speak first of all about the need of developing favorable investment environment for foreign investors and the law regulating legal relationships in this sphere has to contribute to the fulfillment of this task.

Economic situation both in Russia and oblast in itself does not sufficiently contribute to the foreign investments. According to the Nizhny Novgorod oblast Committee on State statistics (Analitical note "Activities of joint ventures in 1995" #10-11-59 of 28.03.96) and the data submitted by State Law Department in the beginning of 1996 in Nizhny Novgorod oblast there were registered 476 joint ventures of which only 115 ventures carried out practical activities, i.e. about one third of the total number. Actually this figure remained unchanged since 1994. Production volume of these ventures (in the amount of 1171,5 billion roubles) did not exceed 4% of the total volume of products manufactured in oblast, moreover 95% of this sum is attributed to the "VOLGA" Joint-Stock Company due to which practical growth of production volume, export and import of joint ventures on the territory of oblast has been reached. In the above mentioned note the Committee on State statistics makes a conclusion: "It is quite obvious that State structures have evry reason to encourage establishment and development of enterprises involving large direct investments. In this case it is possible to achieve the initial purpose of establishing Joint Ventures - providing domestic market with high quality goods, allowing to substitute a portion of imported goods of low quality, expanding the geography of export of competitive products with the involvement of hard currency resources".

Thus, both the country and the oblast can undertake effective measures in order to draw attention of foreign investors mainly through providing them with necessary guarantees and privileges.

Firstly, it is necessary to develop a comprehensive regional program for promoting foreign investments in the economy of oblast and, what is more important, to observe its fulfillment. This program should be based on the step-by-step , priority and selectiveness principles. For the development of the regional program it is possible to use Federal Comprehensive Program for Promotion of Domestic and Foreign Investments in the economy of the Russian Federation, approved by the Russian Government Resolution of October 13, 1995, which recommended to the executive powers of the RF subjects to develop similar regional programs.

Secondly, it is necessary to think over the system of providing with tax privileges (for example, complete exemption from oblast taxes for a certain time interval or payments by installments)foreign entrepreneurs and Russian counterparts of foreign investment activities should they participate (fully or partially) in the investment projects which are of primary importance to the oblast.

Thirdly, it is necessary to create an effective access to the information database of potential foreign investors and other interested individuals in order to inform them about the economic situation in the region, its structure, branches, territories and enterprises which need investments and which are able to draw attention of foreign partners.

Fourthly, it is extremely important to provide legal and economic protection of foreign investments. An important role here may be played by the guarantees of the oblast authorities. An important guarantee would also be the establishment of Insurance Fund with the oblast authorities participation.

It is extremely important to practically (not only on paper) provide for free

transfer of profits abroad and reinvestment of capital on the territory of RF and the oblast.

So far as there is a deficit of local budget, so far the reliance can be made on non-financial incentives (assistance in acquisition of plots of land, premises, offices, warehouses, information services etc.).

It would be useful to set up oblast network of intermediate organizations which render services to foreign companies and Russian enterprises in the field of business consulting, legal sphere, exercising expertise, marketing, establishing contacts, providing security, including personal security from criminal structure impact etc.

There could be also useful the oblast Law "On investment tenders" which would regulate the issues of state-owned shares sale and develop additional guarantees for foreign investors. For example, similar law exists in the Republic of Karelia.

Thus, we should speak first of all about the necessity of risk level reduction for foreign investors in order to attract their investments on the territory of the oblast.

Despite of high risk level, foreign investors, nevertheless have serious incentives to invest both in Russia and the oblast. First of all this is an aspiration for exploring a vast market (occupation of a "niche") which until recent days was actually closed for the foreigners. It is a possibility of acquisition of access to relatively small, but at the same time rather skilled labor force as well as scientific developments competitive on any market, but which due to different reasons do not receive sufficient development.

One should not forget about the fact to which investors always paid, are now paying and will pay special attention: the infrastructure. Oblast possesses a network of highways and railroads, air-ports, river ports, gas- and petroleum pipelines, telephone, facsimile and satellite communication network (foreign capital shows noticeable interest in the development of telecommunication network), etc.

In a word, when observing certain conditions, N. Novgorod oblast may appear to be rather attractive area for foreign investors. This is just what we have taken into consideration when developing the Draft of Law.

The development of the Draft of Law took place in difficult and even unfavorable political and legal conditions, because the initial document the Law "On foreign investments in the RSFSR" was adopted in July 1991, i.e. even prior to the USSR disintegration and at the same time when the USSR Constitution and The Civil Code of the RSFSR of 1964 were in force. It abounds with such notions as the USSR, the RSFSR, Supreme Soviet, Soviet citizens, soviet currency etc. Since the adoption of this Law, the legislation of RF has undergone considerable changes. Thus, the Civil Code of RF was adopted and as its continuation - the Law "On joint-stock societies". There was also adopted a whole series of normative acts in the sphere of taxation, currency control, regulation of intellectual property copyrights and other fields which have principal meaning for investment activities including those exercised by foreigners. Thus, the above Law of 1991 works without taking into account many these and other legal acts and in many aspects contradicts to them. That is why many of its provisions became obsolete. This is

the reason of its alteration in 1993 and 1995. The subsequent amendments and addenda to the Law of 1991 were scheduled for consideration by the State Duma of RF in June this year, but have not been considered, because up to now the State Duma of RF has accumulated more than 80 Draft of Laws with the infringed dates of consideration, including the Draft of Law on insertion of amendments and addenda to the above mentioned Law of the RSFSR "On foreign investments in the RSFSR" According to the RF Federal Assembly Legislative Initiative Plan of Federation Council for the second half of the year of 1996 (approved by the Resolution of the Federation Council of RF Federal Assembly # 332-SF in August 8, 1996), amendments and addenda to the above mentioned Law will not still be introduced this year. Alongside with this, when developing the Draft of Law we could not but take into account RF Law of 1991, because it is in effect and must serve as a basis for the oblast Law. That is why the whole set of provisions of the Draft of Law submitted for consideration has been taken from it partially unaltered and partially altered with regard to the changes in RF Legislation.

At developing the Draft of Law we have analyzed and taken into account virtually all acting and perspective legal basis relative to the essence of the problem: the above mentioned Law of 1991 with subsequent amendments and addenda, the Law "On Investments Activities in the RSFSR" (edition of Federal Law # 89-F3 of 19.06.1995), and other International legal Acts related to the investment activities in general and foreign activities in particular ("Agreement on Cooperation in the Field of Investment Activities" dated 24.12.1993, Resolutions of RF Government, the Decrees of the President of RF, letters of the RF State Customs Committee and State Tax Service of RF); legislative acts of the oblast level (Charter of the N. Novgorod oblast, an Agreement on division of subjects of competence and powers between State Administration of RF and authorities of N.Novgorod oblast) and others. We have also analyzed the Draft of Laws "On insertion of amendments and addenda to the Law of the RSFSR "On foreign investments in the RSFSR" which the Deputies submitted to the State Duma of RF last year and which have been rejected by the Duma under these or those reasons.

The need for adoption of the oblast law "On foreign investment activities in N.Novgorod oblast" is stipulated not only by the fact that the Federal Law of 1991 has become obsolete and contradicts to the basic current legislation. Federal legislation on foreign investments has a number of gaps which have to be eliminated in the oblast Law. These include a specter of privileges and guarantees on the oblast level, legal rights of Russian participants of foreign investment activities, the oblast Administration incentives of foreign investment and others.

It is obvious, that only the oblast Law can take into account regional features and provide with the oblast Administration guarantees including, for example, protection of rights and interests of the subjects of foreign investment activities before Federal authorities and in court. The motivation of the adoption of the Draft of Law by the N.Novgorod oblast Legislative Assembly comes out from the provisions of clauses 71 and 72 of the Constitution of RF and the Agreement on the division of subjects of competence and powers between State Administration of RF and the authorities of N.Novgorod oblast, dated June 8, 1996.

The proposed Draft of Law by its legal nature bears a comprehensive character, i.e. it includes provisions of various branches of current legislation. We selected this way instead of developing a small, but at the same time reduced Draft of Law in the form of additional guarantees and privileges for implementing foreign investments in the N.Novgorod oblast. We found it reasonable to fill the Draft of Law with some notions which are absent in Federal legislation such as, for example, "foreign investment activities", "participants (subjects) of foreign investment activities and others, taking into account the fact, that foreign investment is not only financing, but extended in time process which has certain phases and requires managing and supervision. We tried to provide for the new phenomena in RF legislation: concession, leasing, franchising and others. Alongside, we deliberately refused to introduce into the Draft of Law some of the provisions, attributed to the competence of Federal legislation which are there explained and regulated (for example, issues of enterprise registration and others), trying to make the Draft of Law compact and easy for understanding and implementation in practice. At the same time we tried to maximally fill the Draft of Law with the oblast Administration guarantees, including protection of rights and interests of subjects of foreign investment activities before Federal authorities and in court, attachment of status of primary significance to investment projects and others.

A considerable assistance in developing the Draft of Law and searching for necessary information was rendered by: Committee on International and Inter-regional relations of the N.Novgorod oblast Legislative Assembly (chairman is Mrs. Nina Zvereva), Deputy director of the State Duma of RF Machinery, Mr. Yeltchev Victor, Director of the Department for Economic Cooperation at the Ministry of Foreign Affairs of RF, Mr. Smirnov P.S., Representative of the Ministry of Foreign Affairs in N.Novgorod, Mr. Mitin Vyatcheslav, and also Doctor of legal sciences, professor Mr. Ustinov Valery (Ph.D.) and heads of legal department of the "Sokol" airplane construction plant, who kindly extended us their encouraging opinions on the Draft of the Law.

This Draft of Law (as any other) is not free from drawbacks and in order it could be not only adopted but could work, various opinions and comments are required. That is why we thank you for your attention to our work. Any critical comments on the Draft of Law will be appreciated.

Sincerely yours,

Vadim V. Mramornov
Head of Legal Department,
Industrial Consulting Group, Ltd.

draft

submitted by the Committee
on International and Inter-regional relations
of the Nizhny Novgorod oblast Legislative Assembly

developed by consulting firm
"Industrial Consulting Group, Ltd."
on instructions of the Nizhny Novgorod
oblast Legislative Assembly

Nizhny Novgorod oblast

L A W

ON FOREIGN INVESTMENT ACTIVITIES IN NIZHNY NOVGOROD OBLAST, RUSSIA

Part I.

GENERAL PROVISIONS

Article 1. This Law is adopted in conformity with legislation of the Russian Federation and the Nizhny Novgorod oblast as well as with International agreements in which the Russian Federation is a participant.

This Law is intended to attract foreign investments on the territory of the Nizhny Novgorod oblast (hereinafter referred to as "oblast") and to provide equal protection of rights, interests and property of foreign investors and other participants (subjects) of foreign investment activities, is in force on the territory of the oblast with regard to all participants (subjects) of foreign investment activities excluding those prohibited by legislation of the RF.

This Law in combination with other Federal laws, legislative acts and international agreements of the RF regulates legal relationships concerning implementation of foreign activities on the territory of the oblast, defines legal and economic conditions for attracting foreign investments and implementation of foreign investment activities as well as investment policy on the territory of the oblast.

Article 2. For the purposes of this Law the following notions are given:

"Foreign investments" - productive and unproductive investments in the form of financial resources, demand bank deposits, credits, shares and other securities; technologies, machines, equipment, licenses; any other property or property rights, intellectual property i.e. property and intellectual valuables with financing source outside

the RF and invested in the objects of business activities on the territory of the oblast by foreign investors in order to gain profit by achieving socially useful result.

"Foreign investor" - participant (subject) of foreign investment activities which has not Russian citizenship or has Russian citizenship abroad, is not registered as Russian legal entity or registered on the territory of RF as foreign legal entity and which invests his own or borrowed funds in form of investments for carrying out business activities on the territory of the oblast.

"Foreign investment activities" - not prohibited by legislation of the RF and oblast activities in form of preliminary investment research, allocation of investments on the territory of oblast in any form and management of the allocated investments by the participants (subjects) of foreign investment activities.

"Participants (subjects) of foreign investment activities" - subjects of civil legal relationships against foreign investment agreements, regardless of the types of property, citizenship, country of registration or location of legal entity, which work on the territory of the oblast.

Article 3. Types of foreign investors and participants (subjects) of foreign investment activities and their rights

Foreign investors on the territory of the oblast may be foreign citizens and foreign legal entities of any kind, entities without citizenship; citizens of RF who are the residents outside of the RF, foreign funds, associations, stock-exchanges, foreign investors associations; states and international organizations, i.e. entities with legal right to implement foreign investments in conformity with legislation of the country of citizenship, location or registration.

Participants of foreign activities on the territory of the oblast except for the entities mentioned in the first part of this Article may be Russian citizens and legal entities; Federal, oblast and municipal administration authorized to manage State and municipal property and property rights, i.e. Russian investors implementing activities on the territory of the oblast in cooperation with foreign investors.

Foreign investors and participants of foreign investment activities independently determine directions, forms and volumes of investments, conduct on the territory of the oblast other necessary for investment activities actions which are not directly prohibited by legislation of the RF and the oblast.

The basis for foreign investment activities on the territory of the oblast is investment agreement which stipulates the rights, duties and responsibilities of the parties involved. Terms and order for concluding concession agreements, limits of their validity as well rights, duties and responsibility of the parties are defined by the RF legislation.

Foreign investors and participants of foreign investment activities on the territory of the oblast enjoy all guarantees and privileges provided by this Law and other legal acts with regard to foreign investments.

Article 4. Types of foreign investment activities

Foreign investment activities on the territory of the oblast may be carried out in the following terms:

- financial participation of foreign investors in the existing enterprises or enterprises being established on the territory of the oblast in cooperation with legal entities and (or)

citizens of the RF;

- establishment of enterprises owned completely by foreign investors as well as of subsidiaries of foreign legal entities;
- acquisition of enterprises, buildings, constructions, equipment, shares, bonds, securities and other property except for those prohibited by the RF legislation;
- franchising;
- leasing;
- acquisition of rights to dispose of land and other natural resources;
- acquisition of other property rights in accordance with legislation of the RF and the oblast.

Any other foreign investment activities is permitted if it is not directly prohibited by legislation in force on the territory of the RF and the oblast.

Article 5. Objects of foreign investment activities

Objects of foreign investment activities may include established or modernized fixed assets and current assets in branches of economies, in enterprises and territories of the oblast not prohibited for foreign investment by the RF legislation; securities, purpose financial deposits, science and technology products, other objects of property as well as property rights for intellectual property.

Foreign investments may be put into any objects of property regardless of forms, located on the territory of the oblast, including property rights and rights for intellectual property, not prohibited for foreign investments by the RF legislation.

The oblast Legislative Assembly on proposal of the oblast Administration approves the list of objects, industries and territories which have priority for foreign investments.

It is prohibited to put foreign investments into objects of property on the territory of the oblast, establishment or use of which violates legislation of the RF and the oblast, or sanitary-hygienic, ecological, technical and other standards, as well as causes or may cause damage to the rights and interests of citizens, legal entities, the oblast and the RF protected by Law.

The list of industries, productions, types of activities and territories partially or completely prohibited or restricted for foreign investors is defined by the RF legislation.

Part 2

STATE GUARANTEES TO FOREIGN INVESTMENT ACTIVITIES AND PRIVILEGES TO FOREIGN INVESTORS AND PARTICIPANTS (SUBJECTS) OF FOREIGN INVESTMENT ACTIVITIES

Article 6. Definition of the oblast state guarantee

As used in this Law, the oblast state guarantee is defined as an additional, regarding Federal legislation, obligation on behalf of the oblast to ensure proper fulfillment of terms on which foreign investments were attracted. The oblast state guarantees may be given to foreign investors and participants (objects) of foreign investment activities , which act or implement on the territory of the oblast investment project meeting the requirements of this Law.

Article 7. Guarantees of legal regime for foreign investments

Investment on the territory of the oblast is considered to be the right of foreign investors protected by this Law, other Federal and oblast legal acts and international agreements in force on the territory of Russian Federation.

Legal regime for property, property rights as well as activities of foreign investors and participants of foreign investment activities on the territory of the oblast can not be less favorable than legal regime for property, property rights and investment activities of the Russian legal entities and citizens excluding those defined by laws of the RF or Decrees of the RF President.

Any discrimination of enterprises with foreign investment as compared to the rest enterprises operating on the territory of oblast is prohibited. All normative acts setting restrictions in the activities of foreign investors and not prohibited by the RF Laws or Decrees of the RF President are not valid and can not be implemented on the territory of the oblast.

The oblast Administration may set up special privileged regime for foreign investors in those branches of economies which are of particular or primary importance for the oblast.

Article 8. Obligation of oblast in relation to foreign investors and participants of foreign investment activities

The oblast Administration encourages foreign investment activities, contributes to expanding information data base for the sake of foreign investors and participants of foreign investment activities, develops legal basis for implementing foreign investment activities, undertakes measures against unfair competition and can stand surety (guarantee) against obligations for legal entities and individuals resulting from their relations concerning foreign investment activities on the territory of the oblast.

When necessary oblast Administration submits to the RF President and (or) RF Government the Drafts of legal acts concerning the interests of participants of foreign investment activities, contributes to implementation of the right of legislative initiative by the oblast Legislative Assembly in the State Duma of the RF by developing and submitting for its consideration the Drafts of Law on the issues related to foreign investment activities.

With regard to the participants of foreign investment activities, the oblast takes the following obligations:

1) to create region`s image, favorable for foreign investment;

2) not to impede this or that way to the implementation of foreign investment projects including disposal of property owned by foreign investors and participants (subjects) of foreign investment activities;

3) to contribute to foreign investors and participants (subjects) of foreign investment activities within the frames of the Federal oblast legislation in implementing investment projects;

4) duly inform about amendments and addenda of the oblast legislation which can somehow influence conditions of investment project implementation;

5) not to spread for a certain time limits the validity of oblast legal or sub-legal acts, which alter or aggravate conditions for foreign investment, stipulated in investment agreement;

6) to compensate for losses to foreign investor, in the interest of whom state

guarantee was given and which he suffered due to non fulfillment or improper fulfillment of obligations by Russian participant (subject) of foreign investment activities, or illegal acts of governmental bodies and state officials.

Article 9. Sources (funds) of the oblast state guarantees security

Sources (funds) of the oblast state guarantees security may include:
- funds of the oblast budget approved for the current year;
- assets of the oblast out-of-budget funds;
- natural and raw material resources state-owned by the oblast;
- real estate and other property state-owned by the oblast;
-oblast finances which are placed in the fund of foreign investment security (insurance fund).

Article 10. Encouraging foreign investment activities

The oblast Administration may undertake the following steps to encourage foreign investment activities:

- measures in the sphere of taxation: privileged tax rates, temporary exemption from taxes to the oblast budget, tax withdrawal, accelerated depreciation, other measures related to taxation in competence of oblast;

- financial measures: privileged loans (credits), surety (guarantees) for loans, participation in establishment and activities of insurance fund, restricted support of investment projects with the term of recoupment up to 3 years through their certification and bidding;

- conversion of debts into securities (profits accumulated by foreign investors from debt discounting);

- other non financial measures, such as State orders on privileged terms, assistance in establishing infrastructure, assistance in acquisition of plots of land, premises, offices, warehouses, information services and others.

Article 11. Guarantees from compulsory withdrawal as well as from illegal actions of governmental bodies and state officials

Foreign investments and objects of foreign investment activities on the territory of oblast can not be subjected to nationalization, requisition, confiscation and other similar in its nature and consequences measures except for the decision of the authorized Federal bodies in conformity with the RF legislation.

The oblast Administration protects the rights and interests of foreign investors and participants of foreign investment activities before Federal and oblast governments taking into consideration the importance or exclusiveness of foreign investment programs for the oblast.

The oblast Administration has the right to submit to the RF Government the proposals on complete or partial abolishment or suspension on the territory of the oblast of legal acts of the RF Ministries and Departments, violating on the opinion of the Administration, the rights or legal interests of foreign investors and participants of foreign investment activities.

Actions of Federal and Oblast Governments and their officials in regard to foreign

investment activities on the territory of the oblast may be appealed to court by the parties concerned.

Article 12. Compensation of losses to foreign investors and participants of foreign investment activities

In case of nationalization or requisition, foreign investor and participant of foreign investment activities is paid instant and adequate compensation on the basis of independent expert estimation of the value of nationalized or requisited investments or objects of foreign investment activities in conformity with the RF legislation.

When making decisions on nationalization or requisition, Federal bodies authorized to carry out the above mentioned compulsory measures appoint independent experts for estimating the value of withdrawn investments or their value in the objects of foreign investment activities.

Compensation paid to foreign investor or participant of foreign investment activities must correspond to real (market) cost of nationalized or requisited investments or their cost in objects of foreign investment activities prior to the moment when it became known about carrying out or the forthcoming nationalization or requisition.

Compensation must be paid without justified delay in currency in which investments were originally implemented, or in other foreign currency upon the agreement with foreign investor. The sum of compensation is charged with interests prior to the moment of payment according to the interest rate of the RF.

Foreign investors and participants of foreign investment activities have the right for compensation of losses, including missed profit, which they suffered from illegal actions of state authorities and their officials due to improper fulfillment of duties provided by legislation with regard to foreign investor or participant of foreign investment activities and also in case of infringing the implementation of investment project after being certified on independent of foreign investor reasons.

Compensation of losses caused to participants (subjects) of foreign investment activities by illegal actions of state authorities or their officials on the territory of the oblast as well as due to improper fulfillment of the duties provided by legislation, is carried out from the sources mentioned in the Article 9 of this Law with subsequent compensation from the fund of State authorities or state officials guilty in losses through addressing the court.

Article 13. Guarantees of money transfer with regard to foreign investment activities

After paying taxes and levies existing on the territory of the RF and the oblast, foreign investors are guaranteed with free transfer of profits gained in result of foreign investment activities to abroad , or reinvestment on the territory of the RF or the oblast or other disposal of funds in conformity with the existing the RF and the oblast legislation.

Article 14. Guarantees in case of changes in legislation

The oblast guarantees protection of rights of foreign investors and participants of foreign investment activities, foreign investments, objects and conditions of foreign investment on the territory of oblast regardless of the types of property through providing conditions for foreign investment activities which would exclude adoption of

legal acts or implementation of measures impeding foreign investment activities on the territory of the oblast.

The oblast informs foreign investors and participants of foreign investment activities in advance about forthcoming changes in legal norms through publications in mass media and on TV.

In case of adoption of the oblast legislative acts, provisions of which affect the rights of foreign investors and participants of foreign activities, corresponding provisions of these acts are not implemented for three years since the moment of coming into force.

Article 15. Accelerated depreciation at enterprises with foreign investments

The oblast Administration has the right to give foreign investors and participants of foreign investment activities on the territory of the oblast a possibility of accelerated depreciation in the order and under the terms defined by the RF legislation.

Article 16. The right of foreign investors and participants of foreign investment activities for additional tax privileges and guarantees. The order of attaching foreign investment projects with a status of particular importance.

In case the oblast Administration recognizes investment projects as having particular economic or social importance for the oblast, foreign investors and participants of foreign investment activities have the right to enjoy additional privileges and (or) state guarantees stipulated in each particular case on the grounds of written application submitted by foreign investor or participant of foreign investment activities to the oblast Administration.

Assessment of foreign investment projects with the purpose of attaching them with the status of particular importance may be carried out either by the authorized State bodies or on instructions from the oblast Administration, by independent expert (consulting) institutions should the applicants submit the following documents:

- written application of foreign investor or participant of foreign investment activities with a request to carry out an expertise of foreign investment project, pointing out the location, legal status of foreign investor, its organizational and legal structure and sources of investment;
- investment agreement;
- business plan or feasibility report;
- information on the Russian participant and its financial activities;
- project of state guarantee or privilege required.

Institution authorized by the oblast Administration to carry out assessment of foreign investment project has to submit the conclusion to the Administration within thirty days since receiving the authority.

In compliance with the Decree of the oblast Legislative Assembly, the investment projects attached with the status of particular importance are granted with privileged regime of taxation or complete exemption from taxes for a certain period of time, or postponement from taxation in force in the oblast for a certain period of time.

The oblast Administration applies financial and non financial measures and provides for the necessary guarantees except for those provided by this Law which do not contradict to the RF and the oblast legislation within its authorities.

Article 17. Criteria taken into consideration at solving the problem of attaching foreign investment projects with a status of particular importance

When solving the problem of attaching foreign investment projects with a status of particular importance it is obligatory to take into consideration the following:

- economic and social significance of the project for the oblast;
- volume of investments;
- legal status of foreign investor, its solvency;
- type of risk for which guarantees are requested (political, legal, economic);
- risk level at implementation of the project;
- sources (funds) of security of guarantees, requested by investor.

Article 18. Terms of refusal in giving the oblast state guarantee or privilege

The oblast state guarantee or privilege may not be given in the following cases:

1) when the list of the documents mentioned in Article 16 of this Law is not submitted;

2) when the results of the expertise confirm the uncompliance of the project to the criteria of the Article 17 of this Law, or the implementation of the project on the territory of the oblast is inexpedient;

3) when obtaining information on financial or business untrustworthiness of one of participants of investment agreement;

4) when it is determined that the documents contain unreliable information.

Article 19. The procedure of drawing up an agreement on providing of the oblast guarantee or privilege. Supervision over implementation of investment agreements.

Basing on the positive decision on providing of the oblast state guarantee or privilege, the authorized governmental body draw up an agreement with foreign investor or participants of foreign investment activities on guarantee obligations of the oblast or a privilege given, which should contain the type of guarantee or privilege, provision on the procedure of solving disputable issues and also the provisions and procedure of suspending state guarantee or privilege in case of non fulfillment or unfair fulfillment of obligations by foreign investor or participant of foreign investment activities in the process of investment project implementation. Guarantee agreement contains a reference on the Resolution of the oblast Legislative Assembly and is signed by the Governor of the oblast.

In order to properly execute the investment agreement guaranteed by the oblast, the authorized governmental body registers the guarantees given, keeps records and supervises the process of implementation of investment process. Procedure of registration, recording and supervision is approved by the Governor of the oblast.

Investment project given the oblast state guarantee or privilege is subject to certification in the order defined by the RF legislation.

Article 20. Property and risks insurance

Foreign investments and risks as well as objects of foreign investment activities may be and must be insured in cases provided for by the legislation.

For foreign investment activities insurance from non commercial risks, the parties and enterprises concerned establish the Insurance fund.

The insurance fund has the right to place its assets both on the territory of the oblast and outside of it including other country on the agreement between the participants of the Insurance fund.

The oblast Administration participates in the Insurance fund as a guarantee of foreign investment activities on the territory of the oblast and in order to directly participate in the Insurance fund activities.

Participants (subjects) of foreign investment activities have the right to involve foreign insurance companies for concluding of all types of insurance transactions.

Article 21. Procedure of solving disputable issues

Disputes on foreign investment activities on the territory of the oblast are solved in the order established by the RF legislation and international agreements in force on the territory of the RF.

Disputes on the sum, conditions or procedure of paying compensation and losses in case of nationalization or requisition, or illegal actions of state bodies or their officials in regard to the subjects of foreign investment activities are to be solved in court.

Disputes between subjects of foreign investment activities and the oblast governmental bodies, enterprises, institutions, organizations and other legal entities of oblast, disputes between investors and enterprises with foreign investments on the issues related to their economic activities on the territory of the oblast, and disputes between the participants of an enterprise with foreign investments and the enterprise itself are subject to be considered in Arbitration court of the Nizhny Novgorod oblast or upon the agreement of the parties in the other body defined by them.

The International treaty of the RF may provide for the appeal to international means of solving disputes, arising due to the implementation of foreign investments on the territory of the oblast.

Part 3

ESTABLISHMENT, REGISTRATION AND LIQUIDATION OF ENTERPRISES WITH FOREIGN INVESTMENTS (SUBJECTS OF FOREIGN INVESTMENT ACTIVITIES)

Article 22. Organizational and legal forms and types of enterprises with foreign investments

On the territory of the oblast the enterprises with foreign investments are established in any forms provided for by the RF legislation.

All enterprises with foreign investments on the territory of the oblast have the right to conduct foreign economic activities except for the cases defined by the RF legislation.

The following enterprises may be established and operated on the territory of the oblast:

enterprises with share participation of foreign investors;

enterprises completely owned by foreign investors as well as their branch enterprises, subsidiaries and other separate sub-structures.

Specific procedures of establishment of banks with foreign capital on the territory of

the oblast are defined by the RF legislation on banks and banking activities.

Specific procedures of conducting leasing activities by foreign investors are regulated in the order defined by the RF Government.

Article 23. Procedure of establishment, state registration, suspending and liquidation of subjects of foreign investment activities

An enterprise with foreign investments on the territory of the oblast may be established either through its incorporation or in result of acquisition of shares(contribution, quotas) in the previously established enterprise or through acquisition of the whole enterprise in the order defined by the RF legislation.

In cases provided for by the RF legislation, or on the resolution of the oblast Administration, when establishing an enterprise with foreign investment on the territory of the oblast, a preliminary assessment is to be conducted. All types of expertise, drawing up conclusions and issuing of licenses are carried out in general order in compliance with the RF legislation.

The procedure of drawing up and maintaining of incorporation documents of enterprises with foreign investments is defined by the RF legislation.

The order and time limits of state registration of enterprises with foreign investments, reasons for refusal in state registration, as well as the procedure of restructuring, suspending or liquidation are executed in conformity with the RF legislation. Refusal in state registration and decision on liquidation may be appealed in court.

Enterprise with foreign investments is considered to be established, owns the rights and is charged with the duties of legal entity since the moment of its state registration.

Article 24. Branch enterprises, subsidiaries and representative offices of enterprises with foreign investments

Enterprises with foreign investments enjoy the right to establish branch enterprises with the rights of legal entity as well as subsidiaries and representative offices on the territory of the oblast, Russian Federation and other countries in compliance with the RF legislation and corresponding legislation of foreign countries.

Article 25. Unions of subjects of foreign investment activities

In the order provided for by the RF legislation, foreign investors have the right to unite in unions, associations, concerns, syndicates, inter-industrial, regional and other groups including those with the participation of the Russian legal entities and citizens as well as to enter the previously established unions both on the territory of the oblast and outside of it.

Part 4

TYPES AND CONDITIONS OF FOREIGN INVESTMENT ACTIVITIES

Article 26. Types and conditions of foreign investment activities

Subject of foreign investment activities may conduct on the territory of the oblast any

type of economic activities not prohibited directly by the RF and the oblast legislation.

Products manufactured by the subjects of foreign investment activities are at their full disposal if not otherwise specified by investment agreement.

Types of economic activities which are subject to licensing or certification are carried out after obtaining a license or a certificate but conducted without them or carried out prior to state registration of enterprise with foreign investments, are withdrawn to the state income.

Article 27. Export and import of goods and services

Subjects of foreign investment activities have the right to export their own products (services) and to import products (services) for their own needs in the order and on terms defined by the legislation.

Imported on the territory of the oblast products which according to the legislation are subject to compulsory certification, must have a certificate and a mark of conformity issued in the prescribed order.

Article 28. Customs regulations and duties

Customs regulations on the territory of the oblast are carried out in compliance with the RF legislation.

Property imported on the territory of the oblast as investment of foreign investors in the objects of foreign investment activities on the territory of the oblast, as well as property designated for the own production is exempted from customs duties and is not subject to import duties.

Property imported on the territory of the oblast by foreign employees of subjects of foreign investment activities for their own needs is exempted from customs duties.

Customs duties for other goods transferred via customs boarder of the RF are carried out under common terms in compliance with customs legislation of the RF.

Article 29. Taxation

Foreign investors and Russian participants of foreign investment activities pay taxes defined by the RF legislation and enjoy the right to get all privileges regarding taxation, defined by the RF and the oblast legislation in relation to foreign investments.

Privileges regarding taxation of leasing activities carried out on the territory of the oblast by foreign investors are regulated by the RF fiscal Law.

Control for the purpose of taxation of subjects of foreign investment activities is carried out in the order defined by the RF legislation.

Article 30. Bookkeeping and accountancy

Bookkeeping and accountancy of foreign investment activities subjects on the territory of the oblast are carried out according to the rules in force in the RF and in the country of the origin of foreign investor, if required.

Peculiarities of stating leasing transactions when conducting bookkeeping are prescribed by the Ministry of Finance of the RF.

For the purpose of balance estimation and bookkeeping the subject of foreign

investment activities conducts conversion of foreign currency into roubles at the rate of Central Bank of the RF at the moment of payments and recalculations.

Article 31. Assurance of obligations

Property of subjects of foreign investment activities as well as their property rights may be used as a guarantee on all types of their obligations.

Article 32. Financial, credit, settlement and currency operations

Subjects of foreign investment activities have the right to address foreign banks, firms and organizations for obtaining credits.

Subjects of foreign investment activities implement financial, credit, settlement transactions in conformity with the RF legislation.

Article 33. Rights for intellectual property

Protection and implementation of rights of foreign investment activities subjects for intellectual property are guaranteed in compliance with the RF and the oblast legislation and international treaties in which the RF is a participant.

Interrelations between subjects of foreign investment activities and their employees with regard to the rights for the objects of intellectual property are defined by the RF legislation.

Subject of foreign investment activities on its own decides on patenting abroad of the owned inventions and industrial samples in compliance with the RF legislation.

Article 34. Industrial relations

Subjects of foreign investment activities on the territory of the oblast decide on their own the issues of hiring and dismissing of personnel, conditions of work and rest, payment, guarantees and compensations in conformity with the RF labour Laws.

Foreign citizens may act as workers and clerks, management officials of the subjects of foreign investment activities on the territory of the oblast. Terms of employment, work and rest , as well as provision of pensions for foreign employees are agreed in the individual labour agreement (contract).

Foreign employees` wages in hard currency after payment of income taxes may be freely transferred over the RF boarders.

Article 35. Social insurance and security of employees of foreign investment activities

Social insurance and security of employees of foreign investment activities (excluding provisions of pensions for foreign employees) are regulated by the RF legislation.

Provision of pensions for foreign employees of foreign investment activities is implemented in conformity with the legislation of the countries of their citizenship or residence.

Subjects of foreign investment activities make allocations on state social insurance of Russian and foreign employees and allocations on provision of pensions for the Russian

employees against the rates prescribed for the enterprises and organizations of the RF.

Article 36. Duties and responsibilities of State bodies and officials before subjects of foreign investment activities

When supervising within their competence the observance of the RF and the oblast legislation by the subjects of foreign investment activities, the authorized state bodies and their officials has no rights to violate the rights of foreign investment activities and interfere into their activities.

In case of adoption of illegal decisions or an action infringing legal right of the subject of foreign investment activities, the official is responsible for the decision or action, bears personal responsibility in the order defined by the legislation.

Article 37. Duties of subjects of foreign investment activities

Subject of foreign investment activities must observe:
- the RF and the oblast legislation;
- regulations and standards in force in the RF and the oblast;
- legal demands of State bodies and officials, submitted within their competence.

Article 38. Responsibilities of subjects of foreign investment activities

According to the RF legislation, the subject of foreign investment activities is responsible by all its property located in the RF for non fulfillment or improper fulfillment of obligations under the agreement, violation of credit-settlement discipline, requirements to the quality of products (services), other established rules of implementing business activities as well as of the RF and the oblast legislation.

Part 5

ACQUISITION OF PROPERTY AND PROPERTY RIGHTS BY THE SUBJECTS OF FOREIGN INVESTMENT ACTIVITIES ON THE TERRITORY OF THE OBLAST

Article 39. Acquisition of property

Subjects of foreign investment activities on the territory of the oblast have the right to acquire in ownership buildings, constructions, equipment, other personal and real property, including enterprises as a whole, necessary for implementing their activities in conformity with the RF and the oblast legislation.

Leasing of property to the subjects of foreign investment activities is implemented in conformity with the RF legislation.

Article 40. Acquisition of equities, shares and other securities

Subjects of foreign investment activities have the right to acquire both for roubles and foreign currency equities, shares and other securities of enterprises, located on the territory of the oblast.

Article 41. Acquisition of rights for intellectual property

Subjects of foreign investment activities have the right to acquire on the territory of the oblast the rights for intellectual property in conformity with the RF legislation.

Article 42. Participation in privatization

Subjects of foreign investment activities may participate by their finances in privatization of state-owned and municipal enterprises, as well as of the objects of uncompleted capital construction located on the territory and under the jurisdiction of the oblast in conformity with the RF and the oblast legislation.

Article 43. The right to dispose of land and other natural resources

Subjects of foreign investment activities have the right to dispose of land and relevant real property located on the territory and under the jurisdiction of the oblast in conformity with the RF legislation.

The right to dispose of reproducible and non reproducible natural resources on the territory and under the jurisdiction of the oblast in defined by the RF legislation.

Part 6

FINAL PROVISIONS

Article 44. In case the RF legislation provides for other provision than this Law, then the provision of the Federal Law comes into force.

All issues not covered by this Law are regulated by the RF legislation.

In case of alteration of the RF legislation on foreign investments, this Law is adjusted correspondingly.

Article 45. This Law comes into force from the day of its official publication.

Chairman of the Nizhny Novgorod
Oblast Legislative Assembly

A.A. Kozeradsky

Governor
of the Nizhny Novgorod Oblast

B.Y. Nemtsov

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November 18, 1993

Association of Lithuanian Chambers of Commerce and Industry
Attn: Mr. M. Černiauskas, President

Re: Comments on Draft Project of "Law on Foreign Capital Investment in the Republic of Lithuania"

Dear Mr. Černiauskas:

Mr. E. Blake Mosher, Chief Executive Officer of Mosher International, Inc., recently informed me of your Draft Project of "Law on Foreign Capital Investment in the Republic of Lithuania," and of your desire to receive comments on the draft. This letter contains my comments on the draft laws. Please be aware that the comments that follow are my own opinion and do not necessarily represent the views of Jackson & Walker, L.L.P., my employer.

* * *

Comments on the Draft Project of "Law on Foreign Capital Investment in the Republic of Lithuania": A Free Market Perspective

I. General Considerations—Protection of Private Property Rights

As a general proposition, Lithuania will be successful in attracting foreign capital investments in proportion to foreign investors' ability and chances at making profits in Lithuania. The more that private property is protected under Lithuania's policies, the greater an investor's ability to make more long-range future plans, which increases the chances of success and also increases the amount of profits which can be expected. Additionally, if an investor's property rights are well-protected, he is also more likely to be willing to invest in Lithuania in the first place, since he has more confidence that any profits he earns, he will be able to keep. Finally, a strong Lithuanian policy of protection of private property will reduce the political risk of doing business in Lithuania, which also will increase the amount of profits that can be earned and will decrease the costs of doing business, thereby attracting more investments in Lithuania.

As discussed above, the more that property rights are protected, the more investments Lithuania will attract. Further, Lithuania gives up nothing at all by strengthening investors' private property rights, except the discretion to expropriate investors' property. However, in order to become successfully industrialized, Lithuania will have to refrain from such expropriations anyway, in order to have a stable and productive market economy. Thus, it is virtually costless to Lithuania to increase the protections afforded to foreign investors, and this would benefit Lithuania by making it a more attractive place for investors.

With these general considerations in mind, I feel that the Draft Project of "Law on Foreign Capital Investment in the Republic of Lithuania" (hereinafter referred to as the "Draft Law") should be modified to strengthen as much as possible the protections offered to foreign investors. Below I offer my suggestions as to some of the ways in which this might be done.

II. Specific Suggestions

A. International Commitment—Concessions and Stabilization Clauses

Although the Draft Law purports to give investors certain protections and property rights, there is nothing which would prevent the Lithuanian government from changing this law. If an investor must rely upon the existence of the law to be sure that his property rights will be respected, then his property rights will be uncertain to the extent the government is likely and able to simply revise or abolish the law which gives his property protections. Even if the Draft Law were to state that the government may not pass future laws which violate property rights vested in foreign investors by the current law, the concept of "legislative sovereignty" means that a future legislature is always able to change the law.

One way to resolve this problem is to *internationalize* the protections and promises made by Lithuania concerning the sanctity of investors' property. One way to do this is through a treaty, by which a state obligates itself and becomes bound under international law. Although this does not physically prevent the state from breaching the treaty, states are far more reluctant to breach an international obligation than to merely change one of its own internal laws. Thus the Bilateral Investment Treaties ("BITs") entered into between some pairs of nations, such as Russia and the United States, offer strong protections for the property rights of foreign investors.

I would therefore recommend that Lithuania enter into BITs with the U.S. and other Western states.

International law also recognizes the ability of a state to bind itself internationally through individual contracts between the state and foreign investors, sometimes known as concessions, and referred to herein as investor-state contracts. Any such investor-state contract should contain an international arbitration clause, which can give jurisdiction to a neutral third party, as well as a so-called "stabilization clause." The stabilization clause would provide that the law in force in the Lithuania at a given date—typically, the time the investor-state contract takes effect—is the law that will supplement the terms of the contract, regardless of future legislation, decrees, or regulations issued by the government.

Therefore I recommend that all the protections afforded to investors in the Draft Law be internationalized. The Draft Law should include a provision authorizing and requiring the government to issue a form contract or license from the state to the investor, which contains international arbitration and stabilization clauses, and which incorporates all the protections embodied in the Draft Law as of the date of issuance of the license. This would do no more than to extend the protections embodied in the Draft Law into the license, thereby internationalizing and thus strengthening the private property rights afforded in the Draft Law.

Any time an investor began to invest in Lithuania, he would automatically receive such a license from Lithuania, containing a solemn contractual guarantee from Lithuania to abide by the promises made in its Draft Law, and to not change the internal laws of Lithuania in a way that would diminish the property rights guaranteed to him. Investors receiving such licenses would be more confident that Lithuania does not intend to expropriate their property or raise taxes to a confiscatory rate. This would increase Lithuania's attractiveness and stability, would reduce political risks faced by investors, and would thus encourage greater investment into Lithuania.

B. Expropriation of Investors' Property

Article 6: Foreign Investment Guarantees states that "State authority bodies or governmental bodies shall have no right to encroach upon foreign investments or property of foreign investor." This seems to indicate that an investors' property rights should be respected by the government, which implies that the government will not expropriate or nationalize such property. However, the next paragraph states "Compensation for the appropriated property shall be paid no later than within three months in invested currency or Lithuanian national currency, if capital of an enterprise was formed by non-monetary (property) contributions, according to the actual market value of the property." This sentence appears to contemplate government appropriation (i.e., expropriation or nationalization) of investors' property.

My first comment in this regard is that this apparent inconsistency should be eliminated and the law clarified. If no expropriation of private property by the state is to be allowed, the law should not contemplate that it may occur. If, on the other hand, expropriation is to be allowed, it should be limited in scope to only narrow situations.

I would recommend clearly stating that the government does *not* have the right to expropriate an investor's property, nor the right of eminent domain. Since values are subjective, it is impossible to determine an "appropriate" amount of compensation to pay an investor for the "value" of the property which is taken. However, if it is politically unacceptable to remove the government's power of eminent domain, which is likely, the Draft Law should clearly state that, in the event of an expropriation, the full value of the property should be received, which includes the market value of both *lucrum cessans* (future profits lost) and *damnum emergens* (damages). This "full value" standard will help to protect both the value of the investor's property, as well as the property itself, since the government is less likely to expropriate property the more compensation it would have to pay for it.

Additionally, the Draft Law should state that investments shall not be expropriated, directly or indirectly (which includes both indirect and "creeping expropriation"), unless: (1) for a public purpose; (2) performed in a nondiscriminatory manner; (3) upon payment of prompt, adequate and effective (i.e., full value) compensation; and (4) in accordance with due process of law. The law should provide that any legal expropriation that complies with these international law requirements must be accompanied by full compensation, as discussed above; any expropriation not in accordance with these provisions should be deemed an illegal expropriation, and a higher amount of compensation should be awarded—for example, the value of the property take times three, a treble damages standard often found in anti-trust and other laws.

C. Natural Resources

Article 13: Foreign Capital Investment which is Prohibited without Concession, provides that exploration and exploitation of state owned natural resources is prohibited without a concession. As discussed in Part II.A, above, any property rights acquired by investors should be protected also through a standard form of license or other form of investor-state contract, which internationalizes Lithuania's promises to respect the investors' property rights. Certainly a concession, if it contains international arbitration and stabilization clauses, performs this function. Therefore, the concession described in this Article should provide, similarly to the license I suggest in Part II.A, above, that the concession will contain international arbitration and stabilization provisions.

D. Taxation

Article 19: Taxation of Enterprises, should be amended to provide that tax rates shall not be raised higher than the rates in effect at the time the investor began its investment; or, that foreign investors shall never be treated less favorably, i.e., taxed at higher rates, than nationals of Lithuania; or both. The Article should provide that any prohibited increase in taxes includes both direct and indirect tax increases, including the effects of inflation, which is caused by government expansion of the money supply and is economically equivalent to a tax. If these guarantees were fortified by the internationalized, routinely-granted license I suggest in Part II.A, above, investors would be more confident that the taxes in effect currently would not increase and eat away at their profits. This certainty of the ability to earn and retain profits would be an additional incentive for investors to invest in Lithuania.

Moreover, if Lithuania is able to do so, it should eliminate all tariffs and taxes of whatever kind, except perhaps for a modest amount of sales taxes, which could be imposed on foreign investors, with this situation backed by an internationalized promise as discussed above. Lithuania could become a tax haven and the resulting rush of investors to invest in Lithuania could transform its economy virtually overnight.

Alternatively, Article 20: Tax Reliefs and Tariffs, provides for income tax reductions for five and three year periods. These periods should be extended as much as politically feasible, and the percentage reductions on tax rates should be increased as much as politically feasible.

Article 20 also provides that, if an enterprise is voluntarily liquidated during the time when these tax reliefs are in force, or within three years thereafter, the investor must disgorge the "saved" tax reliefs that they received. This provision is one of the worst provisions in the Draft Law. It should definitely be abolished. It is wrong to think that an enterprise can be made to be profitable by force, threats, or coercion, which is what this law amounts to. This law provides a perverse incentive for companies investing in speculative or risky enterprises to *avoid* investing in Lithuania, for it effectively increases the potential losses the investor may face. In order to have successful businesses, businesses must also be allowed to fail when market conditions so dictate. If firms' ability to fail is removed, so is the ability to succeed—just as an individual can only be moral if he is free to *choose* both the right and wrong course of action.

E. Leases on State-Owned Land

Article 14: The Right of Enterprises to Use Land Plots and Real Property provides that State owned land may be leased for enterprise for up to 99 years. This provision should be amended to allow or even require the government to internationalize any such lease, i.e., to

include international arbitration and stabilization clauses in the lease contract to ensure that rights granted to investors-lessees are protected as fully as possible.

F. Reduce Regulations on Acquisitions of Shares

Article 9: The Right of Acquisition of Shares of Enterprises and Credit Companies requires that foreign investors must procure the consent of the Bank of Lithuania in order to acquire up to 20%, 33%, or 50% of the shares of credit companies. Such regulations are unnecessarily burdensome and costly for investors, and tend to increase the cost of business and thus reduce the incentive for investment in Lithuania. Such regulations also presume that the investor has in improper purpose. However, for law-abiding investors, it should be presumed that the investor has no improper purpose and is attempting to legally and properly make a profit by creating wealth. The requirement to obtain the Bank of Lithuania's consent before acquiring varying percentages of shares in credit companies should be deleted or at least diluted or ameliorated.

G. Legal Monopolies and Other Monopolies

Article 10: License to Make a Foreign Investment or to Participate in Certain Types of Activity requires an investor to obtain a license when investing in certain enterprises holding a monopoly in the Lithuanian market. While a legal monopoly, such as the government's monopoly over the printing of money or the building of roads, is a true monopoly, the concept of a non-legal monopoly has always been a problematic one, and legal systems would be well-served to abolish this concept. Typically "monopoly power" is attributed to any successful company that prospers and grows because it is innovative, efficient, and satisfies its customers' demands. Thus to punish firms for being "monopolies" is to punish success and flourishing, which is exactly what Lithuania needs to encourage in order to build a healthy, robust economy. Therefore Article 10 should be amended to require a license only for investments in *legal* monopolies.

H. Prohibited Investments

Article 12: Investment Object wherein Foreign Capital Investment is Prohibited prohibits foreign investments in certain sectors of the economy. Some of these are defensible on sovereignty or national security or defense grounds, such as illegal narcotics and weapons. However, items 5-9—manufacturing of alcoholic beverages; securities, banknotes, coins, and stamps; treating of certain dangerous illnesses; treating animals with certain diseases; and gambling activities—are unduly restrictive. Each of these activities, as long as they are legal, could benefit from the increased capital, know-how, technology, and competition which would result from allowing foreign investors to invest in these areas. For example, if wine or beer can be made more cheaply or more efficiently or in greater variety due to foreign capital or control,

there is no reason to deny Lithuanian citizens the benefits of having greater options to choose from. As the successful history of privatization shows, private enterprises can efficiently perform activities traditionally relegated to government's purview, such as minting of coins. Items 5-9 should therefore be deleted from the list of prohibited investments.

I. Presumption of Permissiveness of Actions

In the original American constitutional system, it was presumed that all actions by individuals were permissible unless expressly prohibited by government. This is a general presumption of individual liberty. The opposite system which has been implemented in certain countries is that only actions which are expressly permitted by the government are allowed, while anything else is prohibited. It is essential for businesses that the former system be in place, rather than the latter.

To that end, the Draft Law should contain a provision which provides that, in cases of doubt or ambiguity, or where the Draft Law or other laws are silent, it is presumed that any investment-related activity of a foreign investor is permissible and legal. Thus, investors would be free to engage in actions not prohibited by the Draft Law. This would increase the certainty of the legality of options open to investors, and would hence broaden their range of legal options, which increases investors' ability and chance of making profit. This, in turn, increases Lithuania's attractiveness as a host country for investment.

J. Contract Rights as Property Rights

Often it is unclear whether contractual rights are property rights or something related, but different. Because contract rights—for example, accounts receivable—are assets as important to many companies as tangible property like land and buildings, the Draft Law should clearly provide that "property" and "property rights" includes all sorts of rights, including immovables such as land, movables such as office equipment, corporeals and incorporeals, intellectual property rights, and contract rights, all of which are equally protected private property rights.

III. Conclusion

In my opinion one of the problems the emerging economies of Eastern Europe face is that too much attention is being paid to the advice of Western *governments*. Western governments are facing their own problems now, primarily because of too much government interference and regulation in the free market, which, ultimately, is the only creator of wealth. Eastern Europe should be wary of accepting the advice of Western governments to tax and regulate the market, adopting our IRS, SEC, and anti-trust laws. The soundest critique of Western economic problems has been that explaining why government intervention and the erosion of property

rights has resulted in our recessions and stagnation. If Eastern Europe's nations would learn from the West's successes—which were built on free enterprise and private property—but also from our mistakes—i.e., too much government—they could be well on their way to economic prosperity. The private property-oriented suggestions offered herein can help lead Lithuania towards this goal.

* * *

Enclosed with this letter are the following articles which you may find of interest and which discuss in detail many of the suggestions made above, written by myself and Mr. Paul E. Comeaux, who also works here at Jackson & Walker in our International Law Practice Group:

- *Reducing the Political Risk of Investing in Russia and Other C.I.S. Republics: International Arbitration and Stabilization Clauses,* RUSSIAN OIL & GAS GUIDE p. 21 (Vol. 2, No. 2, April 1993);

- *Political Risk and Petroleum Investment in Russia,* CURRENTS, INTERNATIONAL TRADE LAW JOURNAL Summer 1993, at 48;

- *United States Bilateral Investment Treaties with Russia and Other C.I.S. Republics,* RUSSIAN OIL & GAS GUIDE p. 23 (Vol. 2, No. 3, July 1993); and

- *Insurance for U.S. Investments in Russia and Other C.I.S. Republics: MIGA and OPIC,* RUSSIAN OIL & GAS GUIDE p. 3 (Vol. 2, No. 4, October 1993).

Also enclosed is an article you may find useful written by Mr. J. Lanier Yeates, a partner in Jackson & Walker's Energy Section and the Head of our International Law Practice Group, and by Gary B. Conine, Professor of Law at the University of Houston Law Center: *Russian Petroleum Legislation: Assessing the New Legal Framework,* RUSSIAN OIL & GAS GUIDE p. 3 (Vol. 2, No. 1, January 1993). I have also enclosed with this letter copies of recent issues of our firm's *International Law Practice Group Newsletter*, each of which also contain a brief description of our firm's international law practice.

If you have any questions or if I can be of further assistance, please do not hesitate to write or call me.

Very truly yours,

N. Stephan Kinsella

Encl.

cc: E. Blake Mosher (Mosher International, Inc.)
J. Lanier Yeates (Jackson & Walker)
Paul E. Comeaux (Jackson & Walker)
Professor Rosalyn Higgins (London School of Economics)

MOSHER INTERNATIONAL, INC.

Fax to: N. Stephan Kinsella

Fax from: Blake Mosher

Pages: 10 (including cover sheet)

Dear Stephan:

Thank you for your time this afternoon on the phone. Per our discussion, please find enclosed a copy of the "Law On Foreign Capital Investment in the Republic of Lithuania". I would appreciate your comments, and I think it would be easiest if you send them back to me so that I can forward them to Lithuania. I would be happy to make any necessary introductions if it would be of any benifit to you or your company down the line.

Please let me briefly introduce our company. Mosher International, Inc. is an international investing firm based here in Houston. We aim to provide venture capital to small and medium sized businesses that are in emerging industries in Eastern Europe and the Former Soviet Union. We are currently focusing on the Baltic Republics dealing with financial services and other key industries. I would be happy to discuss our firm in further detail if you so desire.

Thank you for your time; I look forward to hearing from you.

Sincerely,

E. Blake Mosher
Chief Executive Officer

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MOSHER INTERNATIONAL, INC.

E. Blake Mosher
Chief Executive Officer

TO:
FAX:

FROM: Association of Lithuanian Chambers of Commerce and Industry
FAX: 370 2 222 621

Dear Sir,

our Association has right to offer to Parliament of Lithuania some laws connected with trade and industry and to offer to make a changes at them. We are sending you draft project of "Law On Foreign Capital Investment In The Republic Of Lithuania" and we would be very much intererested to get Your opinion. We know your experiénce in the field of investments, so your point of view would be very valuable before this law will be offered to our Parliament. If it is no trouble, please, let us know your opinion as soon as possible. Thank you for your time in advence.

Sincerely yours,

M. Černiauskas,
President

JACKSON & WALKER, L.L.P.

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TO: MR. E. BLAKE MOSHER, CHIEF EXECUTIVE OFFICER
MOSHER INTERNATIONAL, INC.

FROM: N. STEPHAN KINSELLA

MESSAGE

DEAR MR. MOSHER:

AN ANALYSIS OF THE LITHUANIAN DRAFT FOREIGN INVESTMENT LAW, BASED ON MY COMMENTS PREPARED PER YOUR REQUEST, WILL APPEAR IN THE RUSSIAN OIL & GAS GUIDE (VOL. 3, NO. 2, APRIL 1994). I HAVE ATTACHED A PAGE FROM THE DRAFT OF THE ARTICLE MENTIONING YOUR INVOLVEMENT IN THIS INITIAL COMMENT PROCESS. IF YOU WOULD PREFER I NOT USE YOUR NAME IN THIS FASHION, OR IF YOU HAVE ANY COMMENTS, PLEASE LET ME KNOW BY PHONE (713/752-4360) OR MAIL.

THANKS AGAIN FOR YOUR ASSISTANCE IN THIS MATTER.

—N. STEPHAN KINSELLA

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November 18, 1993

Mr. E. Blake Mosher
Chief Executive Officer
Mosher International, Inc.
1990 Post Oak Boulevard, Suite 1630
Houston, Texas 77056-3813

<BY COURIER>

Re: Comments on draft project of Law on Foreign Capital Investment in the Republic of Lithuania

Dear Blake:

Thank you for your faxed letter of November 15 transmitting the captioned proposed laws and for the opportunity to offer my comments. I have enclosed a package for you to forward to the Lithuanian Chamber of Commerce or to whomever the appropriate Lithuanian addressee should be. I have also enclosed a copy of the contents of this package for you. If you have any questions or need anything further please feel free to call me.

Very truly yours,

N. Stephan Kinsella

N. Stephan Kinsella

Encl.

873

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TO: MR. MENDOGAS ČERNIAUSKAS

PRESIDENT, LITHUANIAN CHAMBERS OF COMMERCE AND INDUSTRY

FROM: N. STEPHAN KINSELLA

MESSAGE

DEAR MR. ČERNIAUSKAS:

PLEASE SEE THE ATTACHED LETTER, CONCERNING MY PUBLISHING OF MY COMMENTS ON THE DRAFT PROJECT ON THE LAW ON FOREIGN CAPITAL INVESTMENT IN LITHUANIA, SUPPLIED TO YOU BY MR. BLAKE MOSHER OF MOSHER INTERNATIONAL, INC.

—N. STEPHAN KINSELLA

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December 14, 1993

Association of Lithuanian Chambers of Commerce and Industry
Attn: Mr. M. Černiauskas, President

Re: Publication of Comments on Draft Project of "Law on Foreign Capital Investment in the Republic of Lithuania" in the *Russian Oil & Gas Guide*

Dear Mr. Černiauskas:

Recently, Mr. E. Blake Mosher, Chief Executive Officer of Mosher International, Inc., informed me of your Draft Project of "Law on Foreign Capital Investment in the Republic of Lithuania," and of your desire to receive comments on the draft. I have previously forwarded my comments by letter dated November 18, 1993, to you through Mr. Mosher.

I have slightly edited my comments on your draft law and put the comments into shape for an article to be published in the next issue of the *Russian Oil & Gas Guide*. If you would prefer that I do not publish my comments along with a copy of the Draft Project supplied to me by Mr. Mosher, please let me know by telephone (713-752-4360) or fax (713-752-4221) as soon as possible, since the deadline for submitting articles to the journal is in a few days.

Thank you for you assistance. Please feel free to contact me if you have any questions.

Very truly yours,

N. Stephan Kinsella

LITHUANIA'S PROPOSED FOREIGN INVESTMENT LAWS: A FREE MARKET CRITIQUE

N. Stephan Kinsella *Jackson & Walker, L.L.P. Houston*

Are foreign investors welcome in Lithuania? The answer to this question depends upon whether Lithuania is willing to protect investors' property rights so that they have an incentive to invest their capital in a risky regime. A government's willingness to protect investors' rights is evidenced, in part, by the contents of its foreign investment laws.

At the time of this writing (Feb. 15, 1994), a Draft Project of "Law on Foreign Capital Investment in the Republic of Lithuania" (hereinafter referred to as the "Draft Law") had failed to pass after being considered by the Lithuanian parliament. Another attempt to have parliament enact the Draft Law is expected.

An examination of the proposed law's provisions, including its deficiencies, may be of interest to Western investors.

Mr. M. Cerniauskas, President of the Association of Lithuanian Chambers of Commerce and Industry, recently contacted Mr. E. Blake Mosher, Chief Executive Officer of Mosher International, Inc., to request Western comments on the Draft Law. Mr. Mosher subsequently contacted me to offer me the chance to comment upon the Draft Law prior to its being voted upon by the Lithuanian parliament. At this writing, the Draft Law is still apparently under consideration by the parliament.

The following analysis is based on the comments I submitted to Mr. Cerniauskas.

The Draft Law

According to Article 1, the purpose of the Draft Law is to "regulate relations between legal persons registered in the Republic of Lithuania and other foreign states, citizens of other states and stateless persons, making investments of their owned assets in the Republic of Lithuania . . . ."

The law also regulates "relations between the State and foreign investors, as well as foreign capital investments during the whole period of their existence."

The law is not intended to regulate "the emergence, transformation and termination of ownership and related legal issues between foreign investor (investors) and legal and natural persons of the Republic of Lithuania . . . ." Nor does the Draft Law "regulate relations between citizens of the Republic of Lithuania and those of foreign states, stateless persons or legal persons of other foreign states, participating in the process of privatization of state property."

Thus, the main purpose of the Draft Law is to provide a framework governing investments in Lithuania by foreign investors. This is accomplished by providing what types of investment are permissible (and in which sectors of the economy), and by providing for a licensing system and for investment guarantees.

General Considerations

As a general proposition, Lithuania will be successful in attracting foreign capital investments in proportion to foreign investors' ability to make (and keep) profits by investing there. Protection of investors' property rights is essential to this. The more that private property is protected in Lithuania, the greater an investor's ability to make more long-range future plans, which increases the chances of success and also increases the amount of profits that can be expected.

Additionally, if an investor's property rights are well-protected, he is also more likely to be willing to invest in Lithuania in the first place, since he has more confidence that he will be able to keep any profits he earns. A strong Lithuanian policy of protection of private property will reduce the political risk of doing business in Lithuania, which will increase the amount of profits that can be earned and will decrease the costs of doing business, thereby attracting more investments in Lithuania.

Further, Lithuania gives up nothing at all by strengthening investors' private property rights—except the discretion to expropriate or steal investors' property. But Lithuania will

have to refrain from such expropriations anyway, in order to have a stable and productive market economy and to become successfully industrialized. Thus, it is virtually costless to Lithuania to increase the protections afforded to foreign investors.

With these general considerations in mind, it is clear that the Draft Law should be revised to strengthen as much as possible the protections offered to foreign investors. Following are some of the ways in which this might be done.[1] (The Draft Law is provided in the appendix to this article.) The foreign investment protections discussed below would be equally beneficial to investors in other developing countries, and even in the West.

Analysis

International Commitment—Concessions and Stabilization Clauses

Although the Draft Law purports to give investors certain protections and property rights, there is nothing that would prevent the Lithuanian government from changing this law. If an investor must rely upon the existence of the law to be sure that his property rights will be respected, then his property rights will be uncertain to the extent the government is likely and able to simply revise or abolish the law which gives his property protections. Even if the Draft Law were to state that the government may not pass future laws which violate property rights vested in foreign investors by the current law, in reality a future legislature is always able to change the law.

One way to reduce this problem is to internationalize the protections and promises made by Lithuania concerning the sanctity of investors' property. This may be done, for example, through a treaty, by which a state obligates itself and becomes bound under international law. Although this does not physically prevent the state from breaching the treaty, states are, practically speaking, far more reluctant to breach an international obligation than to merely change one of its own internal laws.

Thus the Bilateral Investment Treaties ("BITs") entered into between some pairs of nations, such as Russia and the United States, offer strong protections for the property rights of foreign investors. Lithuania should therefore be urged to enter into BITs with the U.S. and other Western states.

International law also recognizes the ability of a state to bind itself internationally through individual contracts between the state and foreign investors, sometimes known as concessions, and referred to herein as investor-state contracts. Any investor-state contract should contain an international arbitration clause, which can give jurisdiction to a neutral third party (such as the International Center for the Settlement of Investment Disputes, or ICSID), as well as a so-called "stabilization clause." A stabilization clause would provide that the law in force in Lithuania at a given date—typically, the time the investor-state contract takes effect—is the law that will supplement the terms of the contract, regardless of future legislation, decrees, or regulations issued by the government.

Therefore, all the protections afforded to investors in the Draft Law should be be internationalized, to help ensure that these protections cannot be arbitrarily overturned by a future legislature. The Draft Law should include a provision authorizing and requiring the government to issue a form contract or license from the state to the investor, which contains international arbitration and stabilization clauses (to internationalize the license), and which incorporates all the protections embodied in the Draft Law as of the date of issuance of the license. This would extend the protections embodied in the Draft Law into the license, thereby internationalizing and thus strengthening the private property rights afforded in the Draft Law.

Under this system, any time an investor began to invest in Lithuania, he would automatically receive such a license from Lithuania, containing a solemn contractual guarantee from Lithuania to abide by the promises made in its Draft Law, and to not change the internal laws of Lithuania in a way that would diminish the property rights guaranteed to the investor. Investors receiving such licenses would be more confident that Lithuania does not intend to expropriate their property or raise taxes to a confiscatory rate.

Investors would also feel that a confiscation of their property would be more unlikely to occur, since this would be a breach of international law by Lithuania, which it would probably be reluctant to do. This would increase Lithuania's attractiveness and stability, would reduce political risks faced by investors, and would thus encourage greater investment into Lithuania.

Expropriation of Investors' Property

Article 6: Foreign Investment Guarantees states that "State authority bodies or governmental bodies shall have no right to encroach upon foreign investments or property of foreign investor." This seems to indicate that an investors' property rights should be respected by the government, which implies that the government will not expropriate or nationalize such property.

However, the next paragraph states "Compensation for the appropriated property shall be paid no later than within three months in invested currency or Lithuanian national currency, if capital of an enterprise was formed by non-monetary (property) contributions, according to the actual market value of the property." This sentence appears to contemplate government appropriation (i.e., expropriation or nationalization) of investors' property.

This apparent inconsistency should be eliminated and the law should be clarified. If no expropriation of private property by the state is to be allowed, the law should not contemplate that it may occur. If, on the other hand, expropriation is to be allowed, it should be limited in scope to only narrow situations, since any encroachment upon investors' property rights will harm Lithuania by making it a less attractive place to invest in.

The Draft Law should be revised to clearly state that the government does not have the right to expropriate an investor's property, nor even the right of eminent domain. Since values are subjective, it is impossible to determine

an "appropriate" amount of compensation to pay an investor for the "value" of the property which is taken.[2]

However, if it is politically unacceptable to remove the government's power of eminent domain, which is likely, the Draft Law should at least clearly state that, in the event of an expropriation, the full value of the property should be received, which includes the market value of both lucrum cessans (future profits lost) and damnum emergens (damages).

This "full value" standard will help to protect both the value of the investor's property, as well as the property itself, since the government is less likely to expropriate property, the more compensation it would have to pay for it.

Additionally, the Draft Law should state that investments shall not be expropriated, directly or indirectly (which includes both indirect and "creeping expropriation"), unless the expropriation is: (1) for a public purpose; (2) performed in a nondiscriminatory manner; (3) accompanied by payment of prompt, adequate and effective (i.e., full value) compensation; and (4) in accordance with due process of law.

The Draft Law should also provide that any legal expropriation that complies with these international law requirements must be accompanied by full compensation, as discussed above. Any expropriation not in accordance with these provisions should be deemed an illegal expropriation, and a higher amount of compensation should be awarded—for example, the value of the property taken times three, a treble damages standard often found in anti-trust and other laws. If treble-damages standards are validly used by governments to deter especially egregious private behaviour, it also makes sense to subject governments themselves to similar penalties, to deter them from breaching fundamental international law.

Natural Resources

Article 13: Foreign Capital Investment which is Prohibited without Concession, provides that exploration and exploitation of state owned natural resources is prohibited without a concession.

As discussed above, any property rights acquired by investors should be protected also through a standard form of license or other form of investor-state contract, which internationalizes Lithuania's promises to respect investors' property rights.

Certainly a concession, if it contains international arbitration and stabilization clauses, performs this function. Therefore, the concession described in this Article should provide, similarly to the suggested license, that the concession will contain international arbitration and stabilization provisions.

Taxation

Article 19: Taxation of Enterprises, should be amended to provide that tax rates shall not be raised higher than the rates in effect at the time the investor began its investment; or, that foreign investors shall never be treated less favorably, i.e., taxed at higher rates, than nationals of Lithuania; or both. The Article should provide that any prohibited increase in taxes includes both direct and indirect tax increases—including the effects of inflation, since price inflation is caused by government expansion of the money supply and is economically equivalent to a tax.

If these guarantees were fortified by the internationalized, routinely-granted license suggested in this paper, investors would be more confident that the taxes in effect currently would not increase and eat away at their profits. This certainty of the ability to earn and retain profits would be an additional incentive for investors to invest in Lithuania.

Moreover, if Lithuania is able to do so, it should eliminate all tariffs and taxes of whatever kind, except perhaps for a modest amount of sales taxes, which could be imposed on foreign investors, with this regime backed by an internationalized promise as discussed above. Lithuania could become a tax haven and the resulting rush of investors to invest in Lithuania could transform its economy virtually overnight.

There is nothing preventing Lithuania, or any other country, for that matter, from doing this, other than anti-capitalistic inertia and ideology.

Article 20: Tax Reliefs and Tariffs, provides for income tax reductions for five and three year periods. These periods should be extended as much as politically feasible, and the percentage reductions on tax rates should be increased as much as politically feasible.

Article 20 also provides that, if an enterprise is voluntarily liquidated during the time when these tax reliefs are in force, or within three years thereafter, the investor must disgorge the "saved" tax reliefs that they received. This provision is one of the worst provisions in the Draft Law. It should definitely be abolished.

It is wrong to think that an enterprise can be made to be profitable by force, threats, or coercion, which is what this law amounts to. This law provides a perverse incentive for companies investing in speculative or risky enterprises to avoid investing in Lithuania, for it effectively increases the potential losses the investor may face.

In order to be successful, businesses must also be allowed to fail when market conditions so dictate. If firms' ability to fail is removed, so is the ability to succeed—just as an individual can only be moral if he is free to choose both the right and wrong course of action.

(This parallel between moral flourishing and flourishing in the market is no coincidence, for the free market, a liberal order under which individuals are free and treated as sovereigns, is the moral economic system.)

Leases on State-Owned Land

Article 14: The Right of Enterprises to Use Land Plots and Real Property provides that State-owned land may be leased for enterprise for up to 99 years. This provision should be amended to allow or even require the government to internationalize any such lease, i.e., to include international arbitration and stabilization clauses in the lease contract to ensure that rights granted to investors-lessees are protected as fully as possible.

Reduce Regulations on Acquisitions of Shares

Article 9: The Right of Acquisition of Shares of Enterprises and Credit Companies requires that foreign investors must procure the consent of the Bank of Lithuania in order to acquire up to 20%, 33%, or 50% of the shares of credit companies. Such regulations are unnecessarily burdensome and costly for investors, and tend to increase the cost of business and thus reduce the incentive for investment in Lithuania.

Such regulations also presume that the investor has in improper purpose, and are thus a form of "prior restraint." However, for law-abiding investors, it should be presumed that the investor has no improper purpose and is attempting to legally and properly make profits by creating wealth. The requirement to obtain the Bank of Lithuania's consent before acquiring varying percentages of shares in credit companies should be deleted or diluted as much as politically feasible.

Legal Monopolies and Other Monopolies

Article 10: License to Make a Foreign Investment or to Participate in Certain Types of Activity requires an investor to obtain a license when investing in certain enterprises holding a monopoly in the Lithuanian market. While a legal monopoly, such as the government's monopoly over the printing of money or the building of roads, is a true monopoly, the concept of a non-legal monopoly has always been a problematic one, and legal systems would be well- served to abolish this concept.[3]

Typically, "monopoly power" is attributed to any successful company that prospers and grows because it is innovative, efficient, and satisfies its customers' demands. Thus to punish firms for being "monopolies" is to punish success and flourishing. Rather, Lithuania needs to encourage success in order to build a healthy, robust economy. Therefore Article 10 should be amended to require a license only for investments in legal monopolies, if at all.

Prohibited Investments

Article 12: Investment Object wherein Foreign Capital Investment is Prohibited prohibits foreign investments in certain sectors of the economy. Some of these are defensible on sovereignty or national security or defense grounds, such as illegal narcotics and weapons. However, items 5-9—manufacturing of alcoholic beverages; securities, banknotes, coins, and stamps; treating of certain dangerous illnesses; treating animals with certain diseases; and gambling activities—are unduly restrictive.

Each of these activities, as long as they are legal, could benefit from the increased capital, know-how, technology, and competition which would result from allowing foreign investors to invest in these areas. For example, if wine or beer can be made more cheaply or more efficiently or in greater variety due to foreign capital or control, there is no reason to deny Lithuanian citizens the benefits of having greater options to choose from. As the successful history of privatization shows, private enterprises can efficiently perform activities historically monopolized by governments, such as minting of coins. Items 5-9 should therefore be deleted from the list of prohibited investments.

Presumption of Permissiveness of Actions

In the original American constitutional system, it was presumed that all actions by individuals were permissible unless expressly prohibited by government. This is a general presumption of individual liberty, and it is necessary for any successful society and economy. The opposite system that has been implemented in certain countries holds that only actions which are expressly permitted by the government are allowed, while anything else is prohibited. It is essential for businesses that the former system be in place, rather than the latter.

To that end, the Draft Law should contain a provision which provides that, in cases of doubt or ambiguity, or where the Draft Law or other laws are silent, it is presumed that any investment-related activity of a foreign investor is permissible and legal. Thus, investors would be free to engage in actions not prohibited by the Draft Law. This would increase the certainty of the legality of options open to investors, and would hence broaden their range of legal options, which increases investors' chances at making profits. This, in turn, increases Lithuania's attractiveness as a host country for investment.

Contract Rights as Property Rights

Often it is unclear whether contractual rights are property rights or something related, but different. Because contract rights—for example, accounts receivable—are assets as important to many companies as tangible property like land and buildings, the Draft Law should clearly provide that "property" and "property rights" includes all sorts of rights, including immovables such as land, movables such as office equipment, corporeals and incorporeals, intellectual property rights, and contract rights, all of which are equally protected private property rights.

Conclusion

One of the problems the emerging economies of Eastern Europe face is that too much attention is being paid to the advice of Western governments. Western governments are facing their own problems now, primarily because of too much government interference and regulation in the free market, which, ultimately, is the only creator of wealth.

Eastern Europe should be wary of accepting the advice of Western governments to tax and regulate the market, adopting our IRS, SEC, and antitrust laws. The soundest critique of Western economic problems has been that explaining why government intervention and the erosion of individual rights, including property rights, has resulted in our recessions and stagnation.If Eastern Europe's nations would learn from the West's successes—which were built on free enterprise and private property—but also from our mistakes—i.e., too much government—they could be well on their way to economic prosperity. The private property- oriented suggestions offered herein can help lead Lithuania towards this goal.

APPENDIX

DRAFT PROJECT: LAW ON FOREIGN CAPITAL INVESTMENT IN THE REPUBLIC OF LITHUANIA

Chapter 1

GENERAL PROVISIONS

Article 1. Objective of the Law

This Law shall regulate relations between legal persons registered in the Republic of Lithuania and other foreign states, citizens of other states and stateless persons, making investments of their owned assets in the Republic of Lithuania, as well as relations between the State and foreign investors, as well as foreign capital investments during the whole period of their existence.

The Law shall not regulate the emergence, transformation and termination of ownership and related legal issues between foreign investor (investors) and legal and natural persons of the Republic of Lithuania, with the exception of cases established by this Law.

The provisions of this Law shall not regulate relations between citizens of the Republic of Lithuania and those of foreign states, stateless persons or legal persons of other foreign states, participating in the process of privatization of state property.

Article 2. Definitions

Definitions as used in this Law.

"Objects of Investment" - production, trade, services.

"Entities of Investment" - legal persons, registered in foreign states, who make investments of foreign capital in the Republic of Lithuania, as well as citizens of other states and stateless persons, permanently residing abroad at the moment of making foreign capital investment.

"Foreign Investor (Investors)" - an investment entity whichever pursuant to the procedure established by laws has invested its owned assets in the Republic of Lithuania.

"Foreign Capital" - to an investment entity by the right of ownership, the following assets belonging:

1)convertible currency;

2)evaluated in convertible or Lithuanian national currency:

a)real estate (buildings, constructions, premises and other real estate), located in the Republic of Lithuania or in other foreign states;

b)industrial or intellectual property;

c)movable property;

used to form or increase authorized capital.

"Foreign Capital Investment" - single legal action by which an investment entity puts its owned capital in the Republic of Lithuania.

"Foreign Capital Investments" - investment of investor's capital in production, trade, services provided.

"Enterprise" - a newly established, reorganized or operating enterprise whereto a foreign capital is invested.

"Enterprise Controlled by Foreign Investor (Investors)":

-upon the establishment, reorganization or participation in the operating enterprise the newly emerged right for a foreign investor (investors) to determine character or type of activity of an enterprise or to manage it (by a direct control right);

-by the establishment agreement of an enterprise and bylaws or acts of management bodies of an enterprise the granted right to a representative or representatives of an investor (investors) to determine character and type of activity of an enterprise or to manage it (by indirect control right).

"Investment Dispute" - a dispute between a foreign investor (investors) and the Republic of Lithuania on the amount of compensation for the appropriated property order and conditions of payment.

"Concession" - the compensation agreement for the permission to exploit state owned resources for a period defined in the agreement.

"National Regime" - legal environment whereat legal persons registered in foreign states, citizens of other states and stateless persons at the moment of making investments and within the period of existence of the investment enjoy the very same rights and have the very same responsibilities equal to those of legal and natural persons of the Republic of Lithuania, with the exceptions of cases established by this Law.

Chapter 2

FOREIGN CAPITAL INVESTMENT

Article 3. Forms of Foreign Capital Investment

Investment entities shall enjoy a right, without any restrictions, with the exception of cases established in Article 10 of this Law, to invest their owned capital in the Republic of Lithuania by the following forms:

1)establishing an enterprise;

2)acquiring securities of operating enterprises;

3)establishing a commercial bank or acquiring shares in operating banks.

Legal persons, registered in foreign states, are entitled to open their mission in the Republic of Lithuania, which is not a legal person and may not be involved in economic-commercial activity.

Legal persons, registered in foreign states, are entitled to establish their branches, as well as establish subsidiaries or manage them.

Article 4. National Regime

National Regime shall be applied to investment entities that invest their capital in the Republic of Lithuania.

Investment entities are considered foreign investors from the moment of establishment (registration) of an enterprise or acquiring shares of stock or bonds.

Article 5. Amount of Foreign Capital Investment

Amount of foreign capital investment shall have to be not bellow than one thousand USD or equivalent in other convertible currencies, with the exception of cases set forth by Article 3 of paragraph 1, 2 and 3 subparagraphs.

Article 6. Foreign Investment Guarantees

Foreign investments, investor's profit, income, rights and legal interests in the Republic of Lithuania shall be protected by the State of Lithuania.

State authority bodies or governmental bodies shall have no right to encroach upon foreign investments or property of foreign investor.

Compensation for the appropriated property shall be paid no later than within three months in invested currency or Lithuanian national currency, if capital of an enterprise was formed by non- monetary (property) contributions, according to the actual market value of the property.

Compensation, received for the appropriated property, at the request of investors (investor) shall be transferred abroad without any restrictions.

Foreign investor (investors) in cases of investment disputes shall be entitled to apply directly to the International Centre for Settlement of Investment Disputes (I.C.S.I.D.), with reference to Convention "On Investment Disputes between Countries and Citizens of Other States" norms, adopted in Washington 18 March, 1965.

Article 7. Establishment, Operation and Liquidation of an Enterprise

The procedure of establishment, operation and liquidation of enterprises and their legal status shall be defined according to the law of that type of enterprise.

Enterprises shall be registered by the procedure established by the authorized governmental body.

The procedure of establishment of a commercial bank with foreign or mixed capital shall be defined by the "Law on Commercial (Stock) Banks of the Republic of Lithuania".

Article 8. Formation of Capital of Enterprise

The owned assets of an enterprise shall be formed by monetary and non-monetary (property) contributions, as well as industrial and intellectual property.

Foreign investor shall have to make monetary contribution to the formed owned capital of an enterprise in hard (convertible) currency or in Lithuanian national currency in the manner established by the Government of the Republic of Lithuania.

Upon the agreement of parties, non-monetary (property) or industrial and intellectual property contributions shall be evaluated in convertible currency or Lithuanian national currency.

Article 9. The Right of Acquisition of Shares of Enterprises and Credit Companies

Investment entity is entitled, without any restrictions, to acquire shares of enterprises and credit companies in all property forms, with the exception of cases set forth in this Article.

Investment entity may acquire only registered shares of state and state stock enterprises.

To acquire shares of state and state stock enterprises of specific destination investment entity may only by obtaining license to make a foreign capital investment by order established in Article 11 of this Law.

To acquire, increase (decrease) the amount of shares of credit companies up to 20%, 33% or 50% of a fixed capital of a bank a prior consent of Bank of Lithuania should be received.

Investment entity may acquire shares of enterprises or credit companies of all types of property for hard (convertible) currency or Lithuanian national currency.

Article 10. License to Make a Foreign Investment or to Participate in Certain Types of Activity

Investment entity shall receive a license to make a foreign investment when:

1)investing in state and state stock enterprises of special destination, the list of which shall be approved by the Government of the Republic of Lithuania;

2)investing in an enterprise, holding a monopoly in the Lithuanian market or may gain a monopoly from the moment of making foreign capital investment.

Article 11. The Procedure of Issuing a License to Make a Foreign Capital Investment

A license to make a foreign capital investment in cases set forth by Article 10 of this Law shall be issued by the Government of the Republic of Lithuania or its authorized body.

Foreign capital investment shall be made no later than six months from the date of the receipt of the license.

If the capital of an enterprise is not formed within the fixed period, the license shall be revoked.

Chapter 3

INVESTMENT OBJECTS WHEREIN FOREIGN INVESTMENT IS PROHIBITED OR LIMITED

Article 12. nvestment Object wherein Foreign Capital Investment is Prohibited

Foreign capital investments are prohibited in objects engaged in:

1)economic-commercial activity, related to the security and national defence of the Republic of Lithuania;

2)manufacturing narcotics, narcotic, harmful or poisonous substances;

3)growing, manufacturing and selling cultures, containing narcotic, harmful or poisonous substances;

4)manufacturing and selling weapons and explosives;

5)manufacturing vodka, wine, liqueurs and other alcoholic beverages;

6)manufacturing securities, banknotes and coins, and post stamps;

7)treating persons ill with dangerous and especially dangerous diseases, including venereal diseases and infections, skin diseases and aggressive forms of psychic diseases;

8)treating animals with especially dangerous diseases;

9)establishing or operating gambling houses, organizing games of chances or holding lotteries.

Article 13. Foreign Capital Investment which is Prohibited without Concession

Exploration and exploiting of state owned natural resources is prohibited without a concession.

Article 14. Activity of Enterprises, Controlled by Foreign Investor (Investors)

Enterprises, controlled by foreign investor (investors) shall be prohibited from:

1)operating state owned highways, railways, seaports, airports according to their functional purpose, these objects being of national significance;

2)operating oil and gas pipelines, communications, electric power transmission lines, heating systems, and ensuring technical functioning of these objects.

Chapter 4

THE PROCEDURE OF THE ACTIVITY OF ENTERPRISES

Article 15. The Right of Enterprises to Use Land Plots and Real Property

Enterprises shall have the right to own or rent buildings and premises necessary for their commercial-economic activity, as well as to rent plots of land for the construction of said buildings accordingly to laws of the Republic of Lithuania.

State owned land may be leased for enterprise for up to 99 years, with a right of priority for extension of the lease.

Private land shall be rented according to the agreement of parties.

Article 16. Accounts of Enterprises

Balance sheet and statistical accounting prescribed by laws of the Republic of Lithuania shall be applied to enterprises.

Article 17. Interrelations between Enterprises and Financial and Control Bodies

Control over conformity of the business conducted by enterprises with the laws of the Republic of Lithuania shall be exercised by the bodies of State Control and financial bodies of the Republic of Lithuania.

Upon the demand of the bodies of State Control or financial bodies of the Republic of Lithuania, said enterprises must, within the limits established by the laws of the Republic of Lithuania, submit the necessary information on their activities for review.

Article 18. The Responsibility of State Control Bodies and Officers

The control body must ensure the confidentiality of commercial secrets of enterprises reviewed.

The content of a commercial secret is established by the law.

The control body must compensate enterprise for losses incurred.

Losses are completely compensated from the state budget, if the control body proves it obtains no sufficient means to compensate the enterprise for the losses incurred. The procedure and conditions for compensating losses from the state budget is established by the law.

Officers, having revealed commercial secrets of the reviewed enterprise, shall be prosecuted.

Chapter 5

TAXES AND TAX RELIEFS

Article 19. Taxation of Enterprises

The procedure of taxation of enterprises shall be established by the Tax Law of the Republic of Lithuania.

Article 20. Tax Reliefs and Tariffs

If an enterprise is registered in the Republic of Lithuania, profit (income) tax levied on the share of enterprise's profit or income (proportionate to the share of foreign capital in the owned capital of the enterprise), and also reinvested in the production, shall be reduced by 70% for a 5 year period. On the expiry of the period, profit (income) tax levied on the share of the profit (income) due to the foreign investment shall be reduced by 50% for a 3 year period.

The tax reliefs indicated in the first point of this Article shall be applied from the moment of the receipt of profit.

Other tax reliefs shall be applied according to tax laws and other laws of the Republic of Lithuania.

If an enterprise is liquidated by the consent of founders during the time when tax reliefs are valid or within 3 years since the expiration of tax relief term, it must pay the difference between profit tax and profit tax reliefs when they were valid.

Alternative of Article 20

Profit and income of enterprises, registered in the Republic of Lithuania, is taxable in general manner.

Article 21. Responsibility for Violating Tax Law

Penalties, established in the laws of the Republic of Lithuania, for violating of tax laws shall be applied to enterprises.

Article 22. Disposition of Profit or Dividends, Derived from Foreign Capital Investment

Dividends, profit or a portion of a profit in hard currency of a foreign investor (investors) shall be repatriated or transferred abroad without any restrictions.

Foreign investors may also transfer all or a portion of their profit, dividends in form of products or services acquired on the Lithuanian domestic market, or reinvest said income in the economy of the Republic of Lithuania.

Article 23. Customs Reliefs

Contributions of foreign investors to the owned capital during the period of formation or increasing thereof shall be exempt from custom duties.

If an enterprise is liquidated by the decision of founders, assets or part of property repatriated of foreign investors and property acquired by foreign investors for profit or dividends shall be exempt from customs duties.

Chapter 6

FINAL PROVISIONS

If an international agreement sets other conditions of making a foreign capital investment or existence of the investment than this Law, in that case an international agreement shall be prevailing.

Comments

To ensure effective functioning of this Law, it is necessary to make complex amendments in laws related to the establishment and activity of economic entities. For example, the following amendments shall be made in "Law on

Enterprises of the Republic of Lithuania", as well as in other laws:

-to separate a branch from a legal person;

-to clearly define features of subsidiaries;

-to provide a right to establish an enterprise (legal person) for one founder;

-to draft and adopt a law, in which opportunity to form capital of an enterprise on the basis of general partial property of founders would be determined.

Insurance of Enterprises

The property of enterprises in the Republic of Lithuania must be insured by state or private insurance agencies, regardless of whether same is insured in other localities.

The Procedure of Conducting Financial Operations of Enterprises

Financial operations of enterprises shall be conducted through banks registered in the Republic of Lithuania. Enterprises may open bank accounts in other states as well.

References

1. For further discussion of some of the methods for reducing political risk, and related international law issues, discussed in these comments, see the following articles by Paul E. Comeaux and myself: Reducing the Political Risk of Investing in Russia and Other C.I.S. Republics: International Arbitration and Stabilization Clauses, Russian Oil & Gas Guide p. 21 (Vol. 2, No. 2, April 1993); United States Bilateral Investment Treaties with Russia and Other C.I.S. Republics, Russian Oil & Gas Guide p. 23 (Vol. 2, No. 3, July 1993); Insurance for U.S. Investments in Russia and Other C.I.S. Republics: MIGA and OPIC, Russian Oil & Gas Guide p. 3 (Vol. 2, No. 4, October 1993); Political Risk and Petroleum Investment in Russia, Currents, International Trade Law Journal Summer 1993, at 48; and Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance, N.Y.L. Sch. J. Int'l & Comp. L. (1994–forthcoming).
2. The views of the Austrian school of economics on the subjective nature of value are extremely insightful. For a classic treatment, see Ludwig von Mises, Human Action: A Treatise on Economics (3d. ed. 1966) (1949). See also the further Austrian economics insights contained in Murray N. Rothbard, Man, Economy, and State: A Treatise on Economic Principles (1962) (two volumes) and Hans-Hermann Hoppe, A Theory of Socialism and Capitalism: Economics, Politics, and Ethics (1989). For a forthcoming detailed review of Hoppe's latest book, see my article The Undeniable Morality of Capitalism, 25 St. Mary's Law Journal ___ (Vol. 25, No. 4, June 1994) (review essay of Hans-Hermann Hoppe, The Economics and Ethics of Private Property (1993)). To obtain these books, contact the Ludwig von Mises Institute (Auburn University, Auburn, Alabama, 36849, telephone 205/844-2500).
3. See Rothbard, supra note 2, at 604-15, discussing "The Illusion of Monopoly Price on the Unhampered Market. See also Chapter 1 of Hoppe, supra note 2, "Fallacies of the Public Goods Theory and the Production of Security."

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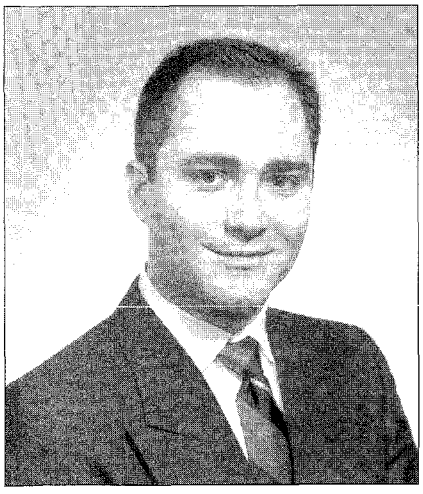

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The Cover
A view of Baku's southern section, with an oil field in the foreground and the newest part of the city across the bay. Photo courtesy of Statoil.

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