

Guarantees Against Nationalisation, Requisition and Confiscation of Foreign Investments in Russia

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The general purpose of the article is to explain in brief the system of legal protection of foreign investmenta in the Russian Federation. Special attention is paid to the issues of nationalization, requisition and confiscation of private property belonging to the foreign investors.

1. Introduction

Is it the right time for making investments in Russia? Russia tries to prove that it is. Investments in Russia can be extremely profitable. But high profits are not enough to make businessmen believe that it is time to do business in Russia. Why? One of the reasons is this: investors are not sure that their property will be safe.

Russia has an unpleasant image of a country in which the right of private property is not respected. The Russian Federation earned this reputation when it was the central part of the USSR. And it is true that there were no legal grounds for protection of private property in the USSR, so the risk of confiscation of foreign investments was high. But maybe the situation has changed now? Let us examine what guarantees against nationalization, requisition and confiscation of foreign investments exist in Russia today.

Guarantees against nationalization, requisition and confiscation of foreign investment are provided in a number of legal acts. We should mention: The Constitution,¹ the Law "On Foreign Investments"² and Section One of the Civil Code of The Russian Federation.³ These acts have supreme legal force.⁴ This is important to know because:

¹ Constitution of the Russian Federation, official publication: edition "Legal Literature" Moscow 1993.

² The Law "On Foreign Investments", official publication: the Gazette of the Supreme Soviet, 1991, # 29, Article 1008.

³ Section One of the Civil Code of the Russian Federation, official publication: the Collected Laws, 1994, # 32, Article 3301.

⁴ The supreme legal force of Constitution is expressed in article 4; the supreme legal force of the Law "On Foreign Investments" is expressed in article 5; the supreme legal force of the Civil Code of the Russian Federation is expressed in article 3.

1. Sometimes laws adopted by a Subject of the Russian Federation⁵ contradict the Constitution, the Law "On Foreign Investments" and the Civil Code. The reason might be that there are some Subjects of Federation which do not support the policy of market economy. These acts of Subjects of Russian Federation are not applied by Russian Courts.

2. Legislation of the former Soviet Union is partly in force. This legislation, however, is very different from the legislation of the new Russia. Sometimes the laws of the USSR contradict the Russian acts. The acts of the former Soviet Union are not applied by Russian courts if they contradict the acts with supreme legal force.

Foreign investors usually do not suspect that laws or other legal acts of Subjects are not valid because they are illegal. And contradictions between former legislation and legislation of new Russia are not always very obvious. So an investor may fulfil the provisions of illegal laws and lose money. That is why it is useful to remember that the Constitution, the Law "On Foreign Investments" and the Civil Code have the supreme legal force and why one should always examine the validity of other laws.

We would very much like to say that investments cannot be nationalized, requisitioned and confiscated. But this is not true. Guarantees provided to the foreign investor against such measures are not absolute. This means that investments can be lost under certain conditions.

2. Nationalization of Foreign Investments

The Russian law contains a brief definition of nationalization. The concept of nationalization is explained in Article 235 of the Civil Code of the Russian Federation. According to that Article, nationalization is "a conversion of property owned by natural persons or legal entities into state-owned property". This means that in case of nationalization the foreign investor loses the right of property which instead becomes the property of Russian state. Under what conditions can investments be nationalized? The conditions are these:

1. The decision to nationalise foreign investments can be made only by the supreme legislative body of the Russian Federation – i. e. the Federal Assembly (article 7 in the Law "On Foreign Investment"). It is clear that no other body has this right. If a body other than the Federal Assembly should take an action that has the same effect as nationalization it is therefore advisable to sue it. A foreign

⁵ The Russian Federation is composed of 89 subjects: 21 republics, 6 regions, 49 "oblasts", 2 cities of federal importance (Moscou and St. Petersburg), 1 autonomous "oblast", 10 autonomous districts. Each subject has its own system of legislation.

investor has the right to obtain a compensation for damages⁶ and moral damages⁷ caused by an action that has the same effect as nationalization, if this action is taken by a body other than the Federal Assembly. This right of the investor is clearly expressed in paragraph 4 article 7 of the Law "On Foreign Investment".

2. But even if a nationalization is performed by the Federal Assembly, the investor has a right to obtain compensation for damages. The compensation should be quick, adequate and effective.

According to Article 8 of the Law "On Foreign Investments", compensation is considered quick if it is paid without unjustified delays. The Russian laws do not explain if a delay is justified or not. There are some rules that help one to find out whether the delay in payment is justified or not. But these rules were developed in order to regulate payments that are made in course of normal business relations. Nationalization is an exceptional measure. Legal relations between the Russian state and an investor are different from those that exist between business partners. That is why we are not sure that a Russian court will apply this rule in order to determine whether the delay is justified or not. But we do not think that this will cause long delays since in case of a delay (whether justified or not) the investor is entitled to get interest for the period of the delay. This right of the investor is clearly expressed in the Law "On Foreign Investments". And we really believe that this right is a good protection for the investor because the interest rate is high in Russia.

A compensation is considered adequate, if, according to Article 8 of the Law "On Foreign Investments", it corresponds to the actual value of the nationalized investment. The actual value is determined immediately prior to the moment when it becomes officially known that nationalization has actually taken place or that it is expected. Certain acts, for example the Resolution of the Presidium of the Supreme Soviet of the Russian Federation dated 27.05.1991, # 1343 — 1,⁸ dealing with the legal conditions of the Free Economic Zone of Sakhalin, indicates that compensation should "correspond to the actual (market) value of the investment nationalized". Thus, the term "actual value" corresponds by its meaning to the term "market value". Therefore, a foreign investor should get compensation that really covers the damage caused by the nationalization.

⁶ According to the said article, damages include: a) real damages and b) lost profits.

⁷ The definition of moral damage is given in article 151 of the Civil Code of the Russian Federation. According to the said article moral damages include: a) physical sufferings and b) moral sufferings.

⁸ Resolution of the Presidium of the Supreme Soviet of the Russian Federation dated 27.05.1991, # 1343-1, official publication: the Gazette of the Congress of Peoples' Deputies of the Russian Federation and of the Supreme Soviet of the Russian Federation, 1991, # 22.

However, the question who is competent to evaluate the investment remains unclear. If the investment is evaluated by the Russian State, a strong underestimation is probable. If it is done by the investor, the value may be overestimated. Therefore, it might be advisable to invite experts who are independent both of Russia and of the investor, for example auditors from a third country. If the investor does not agree with the evaluation it is advisable to present a claim against the Russian Federation. In this case a court decides whether the compensation paid really corresponds to the market value or not.

Compensation is considered effective if it is paid in the currency in which the investment was originally made. If the investor agrees to get the compensation in another currency it will be paid in this currency (Clause 2 of Article 8 of the Law "On Foreign Investments").

Literal interpretation of the mentioned Article allows us to conclude that a foreign investor is entitled to refuse a compensation if it is paid in a currency other than the one in which the investment was originally made. If the investor is offered compensation in such currency the investor has on the other hand to accept it. Let us imagine that an investment was made in roubles (Russian currency). In this case the investor has to accept compensation in roubles. Is it good for him? Probably not. Roubles are not freely convertible; it is not a hard currency. So it is advisable to make investments in hard currency. In this case the Russian state pays compensation in hard currency.

In some international treaties, for example in the Treaty between the Government of the Russian Federation and the Government of the Republic of Poland dated 23.01.1993, #51,⁹ it is specially indicated that compensation is to be paid in a freely convertible currency. Of course, this ensures a greater security for the investor.

3. Nationalization can be performed only "if it is done for the benefits of all Russian citizens" and "in exceptional cases". It means that the state should have extremely serious reasons for nationalization.

The last large-scale nationalization was carried out by the USSR in 1946. The land, banks, big and medium enterprises, communication facilities and other property in the territory of Königsberg Oblast were then nationalized.¹⁰

⁹ The Treaty between the Government of the Russian Federation and the Government of the Republic of Poland dated 23.01.1993, # 61 "On Stimulation and Mutual Protection of Investments".

¹⁰ The Decree of the Presidium of the Supreme Soviet of the USSR dated 21.06.1946, # 111/1 "On Nationalization of Land, Banks, Industrial Enterprises, Railway and Water Transport and Communication Facilities in Königsberg Oblast".

3. Requisition of Foreign Investments

The legislation of Russia contains a detailed legal definition of requisition. According to Article 242 of the Civil Code of the Russian Federation, requisition means "enforced withdrawal of property in cases of natural calamities, accidents, epidemics and other extraordinary circumstances".

The first essential difference between requisition and nationalization is this:

1. Nationalization may cover any kind of investment because the Russian legislation does not contain even an approximate list of property that cannot be nationalized. But there are investments that are not subject to requisition.

Article 242 of the Civil Code of the Russian Federation establishes the approximate list of cases when requisition is possible. Such cases are extraordinary circumstances and calamities presenting threat to the society. Requisition is carried out in order to prevent the consequences of extraordinary circumstances and calamities. For example, in case of an earthquake, transport facilities of a foreign investor may be requisitioned for the transportation of rescuers and wounded. However, it is difficult to suppose that requisition of securities of a foreign investor or of the intellectual property may help to save people in connection with an earthquake. So it is advisable to sue the Russian state if:

a) investments are requisitioned when in reality extraordinary circumstances do not exist,

b) requisition cannot help to prevent the consequences of extraordinary circumstances.

The second essential difference between nationalization and requisition is this:

2. A foreign investor, whose property is requisitioned, is entitled to get the remaining property back when the extraordinary circumstances and calamities are over. This right is clearly stated in Clause 3 of Article 242 of the Civil Code. It means that in case of a requisition the investor loses the right of property but then gets the property back if it was not destroyed during the time of extraordinary circumstances.

It is not absolutely clear who is authorized to make a decision to requisition foreign investments. But we are almost sure that any representative of the State has a right to requisition private property if it may help to save people's lives. Quite often it takes a lot of time to make a decision by the Federal Assembly or by a court. But in case of a natural disaster the State must react immediately. That is why there are no special provisions in the Law that autho-

size just *one* state body to make a decision to requisition investments.

An investor is entitled to get compensation for the damaged property. The quickness, adequacy and effectiveness of compensation are defined in the same way as in case of nationalization. We may draw this conclusion:

In the case of requisition a foreign investor is better protected than in the case of nationalization. First of all because the investor has a right to get his property back after the extraordinary circumstances, secondly because not all investments may be the objects of requisition.

4. Confiscation

According to Article 243 of the Civil Code of the Russian Federation a confiscation is a withdrawal of investments without return. It means that in case of confiscation the investor loses the right of property but does not get any compensation.

Confiscation is a sanction for a serious offence. The offences for which confiscation may be imposed are contained in a number of legal acts.

For example, the Criminal Code of the Russian Federation¹¹ contains a limited number of serious crimes that may have as a sanction the confiscation of property. The Criminal Code establishes responsibility of natural persons only (Article 19). Therefore, only property of foreign investors who are private business people or personal property of managers of a legal entity may be confiscated. Property belonging directly to the legal entity cannot be confiscated.

It is only the court which is authorized to sentence a criminal. So only the court may confiscate private property, and it should have serious reasons for that.

Confiscation may also be imposed for a breach of contract. For example, if an investor signs a contract with the Russian state the fulfilment of his obligations may be ensured by pledge. According to article 336 of the Civil Code any kind of investments can be pledged. If the investor does not fulfil the obligations Russia gets the right to confiscate investments that were pledged by the investor. Confiscation may be imposed for serious delicts committed by a foreign investor as a result of civil liability. The court is authorised to make a decision to confiscate private property of a foreign investor.

Today some administrative bodies still use the right to confiscate property that was granted to them before the Constitution came into force. But their decisions to confiscate property are no longer

¹¹ The Criminal Code of the Russian Federation, official publication: in the Collected Laws, 1996, # 25, Article 2954.

legal. It is so because according to the article 35 of the constitution only a court is authorised to make the decision to confiscate. The contradiction between the Constitution and the legislation of the former USSR is obvious, but Russian officials are very reluctant when it is necessary to apply the provisions of article 35. They require the decision of the constitutional Court that establishes the fact that an administrative body in reality does not have the right to confiscate. Legal procedures in the Constitutional Court are slow, but one by one administrative bodies lose the right of confiscation.

The offences for which confiscation may be imposed are exhaustively described in the acts where these sanctions are found and give, because of that, a good protection for the investors. Procedural rules also prevent illegal confiscations. So we can draw the following conclusions:

Confiscation is only possible when an investor is found guilty or liable for serious offences. If an investor is not found guilty or liable, then there are no legal grounds for confiscation. A court is the only state body that has a right to confiscate foreign investments.

5. Conclusion

Russia provides today a certain minimum of legal guarantees against nationalization, requisition and confiscation. The Russian legislation is developing very swiftly. It becomes more and more close to the legislation of countries with well developed market economies. Russia is open for foreign investments and is ready to change its laws towards a better protection for foreign investors. The right to hold private property is written in the Constitution.¹² And the Constitution and other laws that have supreme legal force are a good foundation for the system of an effective legal protection of foreign investments.

¹² Article 8 of the Constitution of the Russian Federation.