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PRACTICING LAW AND DOING BUSINESS IN THE SOVIET UNION

RICHARD N. DEAN *

Coudert Brothers first began considering the possibility of opening an office in the Soviet Union in early 1987. In January 1987 the Soviets adopted the Joint Venture Law, which, for the first time since the 1920s, created a legal basis for foreign investment in the Soviet Union.¹ There was a belief at that time that commercial transactions in East-West trade would become more complex than they had been before.

I will offer a different kind of approach to some of the issues that Ambassador Gardner has so effectively discussed. My approach to explain what is going on in the Soviet Union is very inductive. Sometimes I feel overwhelmed when I contemplate the barriers with which we are confronted in trying to create an environment in which we can deliver high-quality legal services to our clients. My approach in making these remarks is to draw some conclusions from some very concrete experiences that we have had in Moscow since February 1988. I will start by explaining why and how we decided to start a Soviet practice and open a Moscow office and then discuss some of the ways in which our practice has developed in order to give you an idea of how it has paralleled some developments that the Ambassador and the other speakers have pointed out.

As an aside, most of the legal practice in East-West trade prior to 1987 involved working with "standard form" contracts, usually prepared by the Soviets. The quality of these contracts was usually poor, but few Westerners paid attention to contract formalities, because the Soviets had a good reputation for meeting their commercial obligations in good faith. An example from our experience illustrates what it was like when we first began to confront standard Soviet forms. One of the first transactions we handled involved a sale of substantial quantities of consumer products to a Soviet foreign trade organization for distribution in the USSR. I sat opposite the Soviet negotiating team, which did not include a lawyer. Typical Soviet negotiating teams, at least in those days, limited the role of lawyers to mere technicians. A lawyer would be summoned when the negotiations reached a technical legal question, such as *force majeure*, governing law or dispute resolution. The lawyer, more often than not,

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1. See generally Note, *Joint Venture Law in the Soviet Union*, 11 N.Y.L. SCH. J. INT'L & COMP. L. 499 (1990).

would simply pull out a form book and compare the clause under negotiation to the form book clause. If the two did not match, a bone-crushing negotiation would ensue over the text of the clause, because usually the lawyer had no authority to agree to a variation from the form book clause.

At the beginning of the negotiations to which I referred earlier, I pointed out to the Soviet negotiating team that, although I did not want to be disrespectful, the English translation of their contract in many places did not make much sense. In addition, I explained that certain provisions in the contract conflicted with each other. The Soviets were unfazed. "Mr. Dean," they said, "don't you understand that we buy and sell over two hundred million dollars of products on this form each year. Every major company in the world signs this form, so what makes you think that we will change it for you?" We ultimately compromised. We left the contract intact, but added a lengthy addendum to clarify the ambiguities and resolve the conflicts.

In January 1987, the Soviets also began to decentralize their foreign trade apparatus, which meant that more and more Soviet organizations would have the right to engage in foreign trade directly. Frankly, this is not what really attracted us to open an office but, in retrospect, it has been far more important than the Joint Venture Law. The decentralization was significant because, previously, the state had a monopoly over foreign trade, and all such activity was centrally controlled and administered. Foreign trade was conducted by the former USSR Ministry of Foreign Trade, under which there were specialized foreign trade organizations that acted as intermediaries in buying and selling.

The Joint Venture Law, the decentralization of foreign trade and the overall perception that the USSR was opening up to foreign business formed the context for our consideration of the proposal to open the Moscow office. At the time, the Soviet authorities were interested in having a Western law firm in Moscow. Part of their interest resulted from the belief that if Western service organizations were attracted to Moscow, this would help the flow of capital into the Soviet Union. However, at that time, there was really no legal basis for an organization like ours to have an office in Moscow, except through a process known as "accreditation." If accredited, a foreign company was entitled to open a representative office in Moscow. However, accreditation was possible only after a foreign company had a long and close business relationship with the Soviet Union, which then justified having an office in the USSR. This is very different from qualifying to do business and then commencing operations. You had to have a track record and only then have an office. The actual accreditation process often took as long as two years. In our case, of course, we really had no track record, and we certainly did not want to wait two years to open the office. Fortunately, the Soviet authorities granted us a special dispensation and permitted us to open our

office by subletting space from an existing foreign company. That may seem routine, but the Soviets had never before permitted any American company to sublet space from another organization. Under recently adopted accreditation rules, our method of establishing an office through an existing office has been specifically authorized, which created a clear legal basis for our presence in Moscow.

In 1987, when we were considering the proposal, while no clients were explicitly telling us that they wanted us to have an office in Moscow, there was a sense that business interest was beginning to rise. One of the great features of Coudert Brothers has been its pioneering, entrepreneurial spirit. The firm has been committed to the delivery of high-quality legal services to its clients throughout the world and particularly in emerging, often difficult, foreign markets. All of these factors came together, and the final decision was made on that rather auspicious December weekend in 1987, just after Mr. Gorbachev had jumped out of his limousine on Connecticut Avenue in Washington, D.C. and won the hearts and minds of Americans. Since the Soviet authorities had taken care of all the approvals, I literally just walked into Moscow. Initially, I was held up at the customs check because I was bringing with me the first three months' office supplies. However, when I showed the Custom's office clerk a copy of the article that had appeared on the front page of *Izvestiya*, the state newspaper, which announced the opening of our office, there was no further opposition.

At first our staff consisted of just myself and a Soviet secretary with a word processor. We added a second lawyer at the end of 1988 and a third by the middle of 1989. The office now is staffed with four full-time lawyers and has a fifth slot for a travelling attorney because as transaction burdens ebb and flow we may need more support on the ground. Overall, we have about twenty lawyers in various offices around the world, principally in Washington, New York and Paris, from which we support Moscow.

When we opened the office, the practice consisted of advising clients on joint venture opportunities and other commercial transactions that emerged from those opportunities. Gradually, as the Soviets began authorizing more and more laws which affected foreign business, we began doing more advisory work. Interest in joint ventures has somewhat diminished because of the extraordinary difficulties involved in negotiating and implementing a major investment in the USSR. Joint ventures have turned out not to be the answer to Soviet problems.

There are two particular features of the Soviet legal system on which I want to comment. The first is that, by and large, the system is characterized by inaccessibility. There are a number of permutations to this idea. The first is the inaccessibility of laws for people who need to see them. It is a legal system that, because of the centrally-planned economy, is largely an administrative system with tens of thousands of

internal regulations, many of which are not published. Even if they are published, they are done so in a limited fashion and are not generally available. For example, when I arrived in Moscow, I made a list of laws that I would need, by referring to legislation mentioned in the Joint Venture Law, such as accounting rules and labor laws. The list amounted to fifteen or sixteen items. And so I set out to find these laws. A year later I had seven of them. It was an unbelievably frustrating experience just to gain access to rules that were certainly relevant to our clients and any foreign businessmen who would be involved in commercial transactions in the USSR.

The best example of this inaccessibility of laws is the transaction to which I referred earlier when I was describing the problem of dealing with Soviet "standard form" contracts. The transaction is a complex example of what is referred to as "compensation trade," a form of counter-trade in which our client participated with a Soviet Ministry in an activity which generated foreign exchange. A portion of that foreign exchange was then allocated, on the basis of a special USSR Council of Ministers Decree, to a Soviet foreign trade organization (in an unrelated ministry) that purchased consumer goods from our clients.

As an aside, the reason a special decree was required was that otherwise there would be no legal basis for what we refer to as "horizontal" cooperation between two ministries. Ministries are vertically integrated political-commercial units, which are, in fact, organs of the Soviet government. It is a truism of East-West trade that any time a foreign company proposes a transaction, an integral part of which requires cooperation between ministries, the likelihood of failure is quite high. The failure of ministries to collaborate has seriously hindered the Soviet economy. For example, the Soviets have not produced high-quality industrial and commercial lubricants. We worked on a project recently that was related to the development and marketing of lubricants based on Western technology. When the Western party met the Soviet participants at the initial negotiations, it marked the first time that the Soviet parties, one an automotive design enterprise under the Ministry of Automobile and Agricultural Equipment Building, which designs automotive engines, and an enterprise under the Ministry of Petrochemicals and Oil Refining, which designs motor oil specifications, had ever cooperated jointly.

Returning to our "compensation trade" example and the problem of inaccessible laws, I will never forget the day when I had to explain to our client's general counsel the details of the transaction, including, of course, the startling caveat that the transaction was based on a special decree that was a state secret. The closest I had gotten to the decree was to see a Soviet negotiator waving what he said was a copy of it from across the table during a meeting.

Unavailable laws and secrecy are part of the problem. Of course, dealing with the bureaucracy also presents great challenges. Before

perestroika, you knew what you were up against when dealing with the bureaucracy, but now there has been so much change and turmoil that it is extremely difficult to know with whom you may be dealing, particularly on a lower level. For example, when we first opened our office, I met a Soviet official at the Ministry of Justice. He handed me his business card, but everything on it except for his name had been "whited out." I asked him what his job was. He replied that he did not really know yet. I asked him where his office was located. He replied that he expected to have an address in the very near future. When I asked him if he had a phone, he answered, "No, not yet."

Dealing with the bureaucracy can involve much greater problems than mere questions of identity and job description. We were asked by a client to contact a senior official, a department head at the Moscow City Council, in order to ask whether he had reviewed documents that our client had sent to him regarding a potential real estate project. He had provided our client with the direct phone number to his office. Those of you who are experienced in conducting business in the Soviet Union know that it can literally take hours to place a telephone call. The first challenge is finding a working telephone. Next, you must have the correct number, for it is extremely difficult to leave messages for Soviet officials. However, even if you have the correct number, if the Soviet official whom you are trying to contact is not in his office, frequently no one will bother to answer the telephone. In this case, one of our secretaries placed the telephone call and, as luck would have it, reached the official immediately. She explained that she was calling from Coudert Brothers and that one of our lawyers wished to speak with him. He was quite offended that a secretary had reached him directly and replied abruptly that he did not speak to secretaries. He went on to say that if we wanted to speak with him, we would have to make arrangements through his secretary. Then he hung up. Our problem was that we only had his direct line. There are no telephone directories in Moscow, and the challenge of finding his secretary's separate phone number was great. We were not to be denied, however, and so we called the official back. Our secretary, very apologetically, explained that we did not have his secretary's phone number and asked if he could provide it. The official requested that she hold the line a minute, left the phone and several minutes later his secretary picked up the line. Our secretary went through the entire story, concluding by saying that our lawyer would like to speak with her boss. A pause ensued. Finally, she said, "He's not here" and hung up.

The problems of finding laws and dealing with the bureaucracy pales in comparison to the fundamental problems arising out of the Soviet political chaos as they affect commercial transactions. The ongoing debate and struggle among the Central authorities, the republic-level authorities and the local authorities over political and economic rights has severely

hampered foreign investment. The best example of this is what has come to be known as the "DeBeers problem." Some months ago, DeBeers, the South African diamond producer, announced that it had entered into a contract with the Soviet Union, pursuant to which it had been appointed the exclusive world-wide distributorship of Soviet diamonds.² DeBeers had agreed to pay the Soviets millions of dollars in advance for such exclusive rights.³ At the time, the transaction seemed best explained by the growing shortages the Soviets were facing in foreign exchange.⁴ However, several weeks after the transaction was announced, to everyone's surprise, Boris Yeltsin, who only recently had become head of the Russian republic, announced that, since no Russian republic-level officials were involved in negotiating and signing a contract covering diamonds, which were located in the Russian republic, the contract was void.⁵ Several weeks later, the local authorities in Yakutia, the region in which the diamond mines were actually located within the Russian republic, announced that they did not care what Mr. Gorbachev had negotiated or what Mr. Yeltsin had renounced, but that, since the diamonds were located in Yakutia, no contract could be signed for their distribution without local approval.⁶ Therefore, we find ourselves in situations where frequently we must advise clients to obtain approvals at all three levels in order to be sure that their project can proceed. However, the reality of this process is that few, if any, foreign companies have been able to obtain such approvals at these levels. The result has been a dramatic slowdown in natural resource projects in the Soviet Union.

Our job has also been made more complicated by the fact that amidst the political, social and economic chaos of today's Soviet Union, we are witnessing an "explosion" of laws. When we first opened our office in 1988, a foreign lawyer operating in the Soviet Union did not need to know much Soviet law in order to advise Western clients. Of course, it was necessary that he possess some familiarity with the Joint Venture Law and certain other aspects of Soviet law, such as labor laws and tax laws. However, generally, foreigners had very little contact with the Soviet legal system. Routinely, foreign trade contracts were governed by laws other than Soviet law (usually Swedish law), and disputes were resolved by arbitration at a neutral site (usually Stockholm). While Swedish law and Stockholm arbitration continue to remain popular choices in East-West

2. Timberlake, *DeBeers Signs Diamond Pact with Soviets*, Chicago Tribune, July 26, 1990, at C1, col. 1.

3. *Id.*

4. *See id.*

5. *See* Bohlen, *Soviet Zone Strives for Sovereignty and Diamonds*, N.Y. Times, Aug. 15, 1990, at A3, col. 3.

6. *Id.*

contracts, Soviet law has been developing very rapidly. A number of real estate laws, such as laws on property, on land and on leasing, as well as a completely reconstituted corporate and individual taxation system, have been passed by the newly constituted USSR Supreme Soviet. New laws covering patents, environmental protection, antitrust and foreign investment are all under contemplation.

The final area of concern in completing commercial transactions in the Soviet Union, which I would like to address, relates to the general category of "performance problems." Many of you are familiar with the payment problems the Soviets have been confronting over the last six months. It is difficult to overstate the significance of these problems. Our perspective in rendering advice to our clients is to attempt to explain to them how difficult it is to complete a transaction in the Soviet Union. We are not in the business of "selling" the Soviet marketplace. We try to be realistic and thoroughly explain to clients the risks and benefits of proceeding with their proposed projects. Prior to the payment problems, when I would make such presentations to business people experienced in Soviet transactions, they would frequently reply: "We understand the problems, but we have been doing business in the Soviet Union for a long time and we know that no matter how difficult it may be to negotiate the contract and no matter how bad the contract form itself may be, the Soviets always pay and they pay on time." That was true—up until the end of 1989. The Soviets are now suffering from a dramatic cash-flow problem. It may not be too much of an exaggeration to suggest that the Soviet economy, from a foreign exchange point of view, is insolvent in the sense that Soviet organizations have been unable to meet their obligations, at least in the foreign trade area, as they have fallen due. This cash-flow problem is perhaps the first dramatic consequence of the government's policy of decentralization in the foreign trade sector. Certainly the impression, which has been created, is that "things are out of control." Soviet organizations are blaming the Bank for Foreign Economic Relations for failing to advance the funds so that they can honor their contractual commitments. The bank has asserted that the fault lies with the Soviet organizations who have over-extended themselves. At this point, estimates of the trade debt are about \$3.5 billion, and there has been no clear mechanism developed under which foreign companies owed substantial sums are being paid except to appeal to high-level state officials for payment.

There are certainly positive signs on which to focus. At this point, Mr. Gorbachev has largely removed fear as the primary motive for decision-making in the Soviet Union. He has also begun a process that has promoted greater "truth telling" in the USSR. Perhaps, for these accomplishments alone, he deserves to win the Nobel Prize. There is some indication that the Soviets are reaching the conclusion that their centrally planned, command economic structure is an utter failure. How

quickly they can move from that position of failure to a more market-oriented economy remains to be seen. It is not yet clear that they are on a path that will lead to significant economic reform, but there is a growing consensus that dramatic reforms will be necessary. Most analysts agree that the question for the Soviet Union is "when," not "if." That in itself may be an overly optimistic assessment, but one hopes that over the course of the next several years and decades the Soviet Union may begin to make progress toward substantial economic, political and social reforms, which will lead not only to its becoming a more stable trade partner but a more stable political partner in an increasingly interdependent and complex world.

Thank you very much.