NYLS Journal of International and Comparative Law

Volume 11
Number 3 *SYMPOSIA: 1990*

Article 14

1990

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Risks in Investing in the USSR: Can There Be Protection Against Them?

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Risks are inherent in investment in any country, even our own. The topic is on our agenda today because Soviet political and economic distress is front page news in our daily papers.[1] Investors in the United States, indeed, in the Western world, are worried. We read of instability, of nonpayment of contractual obligations, of the threatened dissolution of the Soviet Union as we have known it for over seventy years, of civil war between peoples who are reviving struggles nurtured for centuries, of defiance of the military draft by youths called to the colors and of poor harvests and loss of spirit, not to mention loss of a will to work.[2]

Three weeks ago, I had occasion to take the shuttle plane between Frankfurt and Moscow to attend a conference arranged by the American Bar Association and the Soviet Association of Jurists. The plane was filled to the last seat, but not by tourists. Rather, my companions were German businessmen, obviously commuting on what, for them, was a routine trip. Each carried on his arm the usual plastic bag filled with cartons of cigarettes to use for tips and taxis in Moscow. Each showed familiarity with the plane by heading for the magazine supply concealed in an unmarked overhead container. These were the "pros."

They were mostly middle-aged men who obviously knew their route well. They seemed to be manifesting their lack of fear in doing business with the Soviets. They were on the spot, making friends and talking contracts. Indeed, they were so sure of themselves that I was later to find out that they wondered why the Americans seemed so skittish. They were of the opinion that the Soviet market was no more perilous than those in any part of the Third World.

An acquaintance of some years, a German law professor returning from a law meeting in Canada, also happened to be one of the passengers

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1. *See, e.g.*, Keller, *Four Gorbachev Years: Hope to Disillusion*, N.Y. Times, Feb. 3, 1991, at A12, col. 1; *see also* Keller, *Gorbachev Offers His Plan to Remake Soviet Economy*, N.Y. Times, Oct. 7, 1990, at A8, col. 1.

2. Brady, Galuszka, Reichlin & Kharkov, *Shattered Dreams: Gorbachev Tries to Cure Soviet Economic Ills By Turning to Repression*, BUS. WK., Feb. 11, 1991, at 38.

on the plane. I turned to ask him what German businessmen thought of risking their investments in the Soviet Union. He responded quickly, stating, "Of course we take precautions. We take hostages." I was sure he could not mean human beings. I probed, in my embarrassment over not knowing the way in which he used the word. It seemed that he meant that a German firm doing business always tries to have a payment to withhold or a service that can be postponed until the Soviet side performs. There is room for an implicit threat of non-performance if the Soviet side fails to perform. One-way advantage is an unacceptable risk.

But what if the risk is not merely of performance? What if the Soviet government falls? Press reports have been giving the prime minister, and even Gorbachev, little chance to survive if the political unrest brewing among the vociferous leaders of the republics explodes.[3] Gorbachev is said by many in the streets to rule no more territory than the small spot of land within the walls of the Moscow Kremlin. His writ does not run even to the nearby Red Square beyond the walls, for this is the responsibility of the Moscow City Soviet.

My German friend responded to this mention of the threat of political collapse by saying, "It will be to the advantage of any successor government to continue projects designed for production. The Soviet economy needs us Germans; we can expect to continue our business activity regardless of personalities."

My friend went on to say: "Of course, there are inconveniences, for local governments are now demanding recognition of their newly granted autonomy." I had heard that the Kazakh republic across the Caspian Sea in Central Asia has been telling American oil companies seeking a drilling contract that under the new law, the land and its subsoil are now the property of the republic and not of the federation. This has meant that American businesses have had to negotiate with local officials in regions which previously have been ignored. Reports filter in that authorities in the city of Odessa have refused to grant one of the most prestigious of American negotiators a license to build a plant near the Black Sea because of threatened pollution.[4]

Moscow can no longer make all of the decisions. Another oil company reports that its officials negotiating in the Archangel region of the Far North have to deal with the Province officials since they also rest their authority on their newly granted ownership of land and subsoil. But the Germans claim that all of these decentralizing forces can be accommo-

3. *Id.*

4. Shorgen, *Voters on Ukranian City Want Occidental Plant Closed*, L.A. Times, Dec. 20, 1990, at D2, col. 3.

their authority on their newly granted ownership of land and subsoil. But the Germans claim that all of these decentralizing forces can be accommodated. They are not posing insurmountable obstacles, only an inconvenience. They are not real risks.

"And what if the government falls?" I asked once more. My informant again replied, "That risk is no greater than in Africa. Life must go on in the region, and another generation of leaders must accommodate the demands of their people if they are to feed, clothe and house them. They need production."

Many less dramatic risks have been routinely faced for decades by businessmen involved in drafting contracts. Those with long memories recall the termination of the Lena Goldfields concession in Siberia at the end of the "New Economic Policy" in the late 1920s.[5] The Soviet government delivered the Soviet Treasury bonds to investors in compensation, but later, during a period of political stress with the British government, payment on the bonds was stopped.[6] Bondholders sued in a Westchester federal court, but the Soviet Ambassador entered to plead immunity.[7] In effect the investment was repudiated.

To meet fears of confiscation of current investment, the Soviet Joint Venture Law of 1987, as amended, guarantees investors in joint ventures that their contributions will not be confiscated.[8] Also, President Bush and President Gorbachev took an indirect approach, but an effective one, in the agreement signed at the summit this year. They provided that no discriminatory action may be taken, which suggests that if there is to be confiscation it must be against all the world.[9] Such a radical step is unlikely in a country in great need of foreign aid.

Short of confiscation, less dramatic but important risks are to be anticipated. The export of profits might be forbidden for a time. Again this danger has been anticipated in the Joint Venture Law which guarantees the exportability of profits in convertible currency so long as it has been earned as such, although a withholding tax is levied.[10] The Trade

5. *Soviet Economists Predicts Bright Future for Siberian Discoveries*, 63 Platt's Oilgram News, May 31, 1985, No. 105, at 1.

6. *Action Is Taken on Soviet Notes*, N.Y. Times, Nov, 14, 1955, at 38, col. 5; *Moscow's Debts*, BUS. WK., Nov. 9, 1957, at 146.

7. Carl Marks & Co., Inc. et al. v. USSR, 665 F. Supp. 323 (S.D.N.Y. 1987).

8. McLeod, *Doing Business in the Soviet Union: Managing Risk Open to Negotiation*, CRAIN'S BUS. INS., Nov. 27, 1989, at 3.

9. Agreement on Trade Relations, June 2, 1990, USSR-U.S., 29 I.L.M. 946 (1990).

10. Financial Market Trend, *The International Trade and Financial Situation of Eastern Europe in 1988-1989*, O.E.C.D., Feb. 1990, at 11.

Agreement,[11] which has yet to be ratified, provides that "[n]o restrictions shall be placed by either party upon the export from its territory of freely convertible currency."[12] Until ratification, the foreign party has to have confidence that the law itself will be sufficient protection against the risk.

Tax laws always represent a threat. The major risk is that there will be an unexpected increase in the tax law after the agreement has been concluded. Parties have been able to cover this matter in their agreement, but not always as to local taxes. Perhaps the major protection is provided by the desire of local authorities to develop business in the region. There comes a point when the goose that lays the golden egg is killed, although it may be difficult to convince local authorities that point has been reached, for they tend to have a sense that the goose is very rich.

The remedy may be in renegotiation of the double tax treaty between the United States and the USSR to include investment income.[13] The treaty was negotiated before there was an expectation that foreign private investors could invest in Soviet producing and servicing enterprises. It is understood that the treaty is currently under renegotiation.[14]

Counsel to American investors have already taken into account risks to be protected against when drafting investment agreements, in addition to those already mentioned. Such provisions have become so routine that they have long appeared in the "boiler plate" models in the law firms engaged in U.S.-Soviet trade. They relate to penalties and liquidated damages following delayed deliveries, place of delivery (whether f.o.b. or warehouse) and *force majeure*.

Of course, the ultimate protection, when all else fails, is the arbitration clause, which is currently placed in all contracts, usually following the model agreed upon by the American Arbitration Association and its Soviet counterpart. Attorneys now know the perils of failing to specify the place of arbitration, the agency to be relied upon, the law to be applied and the rules to be applied. Furthermore, every lawyer will be careful to make certain that the law to be applied is substantive law and not conflict of law rules. Arbitration does not, however, ensure that the contract will be performed specifically, but it encourages settlement along acceptable lines. If there is no settlement, it makes possible money damages and assurance of enforcement under the New York Convention

11. Agreement on Trade Relations, *supra* note 9, at 946.

12. *Id.* at 947.

13. *International Taxes Russian Republic Tax Measures Seen Offering Some Improvements Uncertainty*, Daily Report for Executives (BNA), at G-4 (Feb. 14, 1991).

14. *Id.*

on Enforcement of Arbitral Awards.

Regrettably, insurance against risk is not yet available from the U.S. Overseas Private Investment Corporation. The OPIC remains a relic of the Cold War, during which its functions in U.S.-USSR trade were not developed. As the relations of the two countries develop under the Trade Agreement, it may be expected that the usual intergovernmental agreement on OPIC will be negotiated and coverage will be provided.

Attorneys tell me that private insurance companies are now offering political risk insurance through agents of Lloyds of London. As I have not yet seen such a policy, I hope that someone here will inform us of such practice.

Several bar associations on the national, state and city level have set up committees to follow the course of U.S.-Soviet trade under current conditions.[15] They know that negotiators in Washington have before them drafts of treaties designed to protect investment. The USSR has already negotiated quite satisfactory treaties with some other states, and it is hoped that the United States government can obtain similar terms.

The joint venture legislation in the USSR is also being revised with the advice of some American specialists. If this legislation is enacted, together with legislation which will permit the president to submit the Trade Agreement to the Senate for consent to ratification, a considerable number of risks will be obviated. The Agreement's ratification is awaited most especially by copyright owners, for the USSR will then adhere to the Berne Convention of 1971, assuring protection of computer programs, data bases and sound recordings.[16]

I should not conclude without mentioning that many potential investors with long experience in U.S.-Soviet trade have demonstrated their willingness to take a very long view of the risk factor. The potential for trade expansion, the Soviet need for goods in great quantity and the often expressed position of Soviet officials that they prefer to make contracts with old friends, all suggest that, whatever the risks of today, an American firm determined to obtain a share in the future market, whenever it opens, will take the risks.

The Germans are also prepared to take the risks that are involved. This accounts for the packed shuttle planes flying from Frankfurt to Moscow. They believe that doing business with the Soviets at this early stage, even though it is replete with risk, will prepare the way and bring important rewards to those with courage.

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15. *U.S. Soviet Trade Reviewed by City Bar*, N.Y.L.J., Dec. 27, 1990, at 2.

16. Agreement on Trade Relations, *supra* note 9, at 948.