

## NOTE

### STRATEGIC PROTECTIONISM? NATIONAL SECURITY AND FOREIGN INVESTMENT IN THE RUSSIAN FEDERATION

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*Russia recently joined the growing list of nations that formally control foreign investment in “strategic” industries. The new law regulating foreign investment generated mixed reviews, ranging from harsh criticism in the media to restrained optimism from investors. This Note will argue that the new Strategic Sectors Law, though not perfect, is less restrictive than critics claim and helps establish the “rules of the game” for foreign investors in sensitive industries. Most importantly, the law is generally consistent with standards promoted by the Organisation for Economic Co-operation and Development and will likely help promote foreign investment in Russia.*

#### I. INTRODUCTION

Some commentators have criticized Russia’s new law<sup>1</sup> regulating foreign investment in its strategic sectors.<sup>2</sup> This Note will argue that the law is less restrictive than it seems and will likely encourage foreign investment by making the rules in Russia more transparent and predictable. More importantly, the law generally complies with Russia’s goals of encouraging the growth of foreign investment and meets criteria for such legislation proposed by the Organisation for Economic Co-operation and Development (OECD).<sup>3</sup> Finally, based on these criteria and the initial evidence

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1. Federal’nyi Zakon O Poryadke Osushchestvleniya Inostrannykh Investij v Khozyajstvennye Obshchestva, Imeyushchie Strategicheskoe Znachenie dlya Natsional’noi Bezopasnosti Rossiiskoi Federatsii [Federal Law on the Framework for the Realization of Foreign Investment in Economic Organizations Having a Strategic Significance for the National Security of the Russian Federation], Ros. gaz., Apr. 29, 2008, available at <http://www.rg.ru/2008/05/07/investicii-fz-dok.html> [hereinafter Strategic Sectors Law].

2. See, e.g., Natalya Alyakrinskaya, *New Bill Bars Foreigners from Strategic Sectors*, MOSCOW NEWS (Russ.), Aug. 16, 2007, <http://mnweekly.rian.ru/business/20070816/55268300.html>.

3. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], OECD ROUNDTABLE: FREEDOM OF INVESTMENT, NATIONAL SECURITY AND “STRATEGIC” INDUSTRIES 5 (2006) [hereinafter OECD, ROUNDTABLE].

of the law's implementation, this Note will critically assess how well the law compares to the "ideal" and identify areas where the law should be modified or amended.

A. *Russia's Economic Recovery, the Growth of Investment, and Legal Gaps*

Since its recovery from the 1998 ruble devaluation and the rise in world oil and gas prices, Russia has enjoyed robust economic growth.<sup>4</sup> From 2000 to 2007, the influx of foreign direct investment (FDI) increased by approximately 800 percent.<sup>5</sup> The level of FDI as a percentage of gross domestic product (GDP), however, is still low compared to other developed economies.<sup>6</sup> Indeed, the Russian government has made it a priority to encourage FDI, not only as a source of capital, but also for necessary technology and knowledge transfers to Russian enterprises.<sup>7</sup> More importantly, weaknesses in Russia's economy related to underinvestment exacerbated the impact of the 2008 global financial crisis.<sup>8</sup> At the same time, concerns over foreign acquisition of domestic corporations and gaps in the existing legal framework have led the Russian government to consider laws restricting FDI in certain sectors.<sup>9</sup> Then-Russian President Vladimir Putin first spoke to the need for such a law in his annual address to the Federal Assembly in 2005.<sup>10</sup> The State Duma and Federation Council passed the final draft of the Strategic Sectors Law in April 2008, and President Putin signed it into law on May 5, 2008.<sup>11</sup> The Strategic Sectors Law restricts the

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4. See Central Intelligence Agency, *The World Factbook - Russia*, <https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html> (last visited Mar. 26, 2009) (noting that increases in consumer demand and investment has replaced the initial role of the ruble devaluation and rise in oil prices as the main drivers of growth).

5. See ECONOMIST INTELLIGENCE UNIT, *WORLD INVESTMENT PROSPECTS TO 2011*, at 173 (2007) ("FDI inflows averaged a paltry U.S. \$3 [billion] per year in 1998-2002, before picking up markedly . . . to an estimated U.S. \$24 [billion] in the first half of 2007.").

6. See *id.*

7. See *President Welcomes Foreign Investment*, ST. PETERSBURG TIMES (Russ.), Sept. 25, 2007, available at [http://www.sptimes.ru/index.php?action\\_id=2&story\\_id=23087](http://www.sptimes.ru/index.php?action_id=2&story_id=23087). President Putin has stated "[w]e expect that private investors will play an increasingly noticeable and leading role in the large-scale modernization of the economy." *Id.*

8. See generally Peter Rutland, *The Impact of the Global Financial Crisis on Russia*, 48 RUSS. ANALYTICAL DIG. 2 (2008).

9. See *Russia to Restrict Foreign Investment in Strategic Sectors*, RUSSIA TODAY, Sept. 17, 2007, <http://www.russiatoday.ru/business/news/14263>.

10. Vladimir Putin, President, Russ., Annual Address to the Federal Assembly of the Russian Federation (Apr. 25, 2005), available at [http://kremlin.ru/eng/speeches/2005/04/25/2031\\_type70029type82912\\_87086.shtml](http://kremlin.ru/eng/speeches/2005/04/25/2031_type70029type82912_87086.shtml).

11. *Russia's Putin Signs Foreign Investment Law*, REUTERS, May 5, 2008, <http://www.reuters.com/article/reutersEdge/idUSL0514680420080505>. The literal translation of the

level of foreign investment in forty-two different types of businesses, establishes procedures to approve such investments, and defines the rights and obligations of foreign investors.<sup>12</sup> The law also shares many characteristics with similarly-focused laws in a majority of developed countries.<sup>13</sup> Indeed, in recent years, several Western European countries and the United States have adopted or amended laws that regulate foreign investment in certain economic sectors, at least partially due to concern over acquisitions of domestic companies by foreign state-owned companies.<sup>14</sup>

### B. *Taxonomy of Foreign Investment*

In Russia, there are three categories of foreign investment: FDI, foreign portfolio investment (FPI), and other foreign investment.<sup>15</sup> FPI “includes purchase of shares, bonds or other securities of Russian enterprises, at levels below 10 percent of the equity capital.”<sup>16</sup> The other foreign investment category is a mixed bag of various types of credits, including direct lending from foreign banks.<sup>17</sup> FDI generally “occurs when a foreign investor exerts direct control over domestic assets.”<sup>18</sup> This happens in one of two ways: (1) foreign investors start a new business or increase the amount of their ownership in an existing firm; or (2) foreign investors acquire ownership over an existing business.<sup>19</sup> This Note is only concerned with the second type of investment—acquisitions over existing

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law’s title—“On the Framework for the Realization of Foreign Investment in Economic Communities Having a Strategic Meaning for the National Security of the Russian Federation”—is lengthy, leading most commentators to adopt their own title. This Note simply refers to the law as the “strategic sectors law.”

12. See *Russian Law to Limit Investment*, BBC NEWS, May 5, 2008, <http://news.bbc.co.uk/2/hi/business/7384358.stm>.

13. See generally OECD, *ROUNDTABLE*, *supra* note 3 (discussing the general increase in the regulation of strategic industries in developed countries).

14. See Nikolaus von Twickel, *Barriers Going Up All Over Europe*, ST. PETERSBURG TIMES (Russ.), Mar. 14, 2008, available at [http://www.sptimes.ru/index.php?action\\_id=2&story\\_id=25316](http://www.sptimes.ru/index.php?action_id=2&story_id=25316). Many policymakers in developed countries are alarmed by the advent of sovereign wealth funds—state-controlled pools of capital used for strategic investments abroad. Often, legitimate security concerns along with populist sentiments cause politicians to oppose takeovers of domestic companies.

15. See STANISLAV M. MENSHIKOV, *THE ANATOMY OF RUSSIAN CAPITALISM* 335 (2007).

16. *Id.*

17. *See id.*

18. EDWARD M. GRAHAM & DAVID M. MARCHICK, *U.S. NATIONAL SECURITY AND FOREIGN DIRECT INVESTMENT* 2 (2006).

19. *See id.* This distinction is often referred to as “greenfield” investment versus “mergers and acquisitions.” See, e.g., Christiana Ochoa, *From Odious Debt to Odious Finance: Avoiding the Externalities of a Functional Odious Debt Doctrine*, 49 HARV. INT’L L.J. 109, 136 (2008). The definition of FDI under Russian law will be discussed below.

enterprises—which is the subject matter of the Strategic Sectors Law.

This Note has five sections: Section two describes the growth and importance of FDI in the Russian economy; Section three examines the existing legislative and regulatory framework regarding foreign investment; Section four examines the Strategic Sectors Law; and, lastly, Section five analyzes whether the law conforms to OECD's proposed criteria, assesses the law's recent implementation, and suggests improvements or amendments.

## II. BACKGROUND & DISCUSSION

### A. *Foreign Investment in Russia after the Global Financial Crisis*

The Russian economy had enjoyed robust growth for seven years until the abrupt crash in economic activity that occurred in 2008. From 2000 to 2007, Russian GDP grew approximately 6.5 percent<sup>20</sup> and came to 8.5 percent in the first quarter of 2008.<sup>21</sup> By November 2008, however, GDP growth slowed to 1.6 percent<sup>22</sup> and 2009 forecasts averaged around 2.5 percent.<sup>23</sup> In the past eight years, economic output has grown 70 percent, household consumption 115 percent, and wages have risen eightfold.<sup>24</sup> These gains halted in late 2008, when real wages fell by 2.5 percent, the number of unemployed rose to five million,<sup>25</sup> and industrial production fell 10 percent in one month.<sup>26</sup>

A variety of factors fueled Russia's economic recovery, including a "devalued ruble, implementation of key economic reforms (tax, banking, labor, and land codes), tight fiscal policy, and favorable

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20. WORLD BANK, RUSSIAN FEDERATION – COUNTRY BRIEF 2008 (2008).

21. *Russia Enjoys High GDP Growth Rate*, ROSBUSINESSCONSULTING (Russ.), Aug. 25, 2008, <http://www.rbcnews.com/free/20080825103359.shtml>.

22. Toni Vorobyova, *Russia GDP Growth Slows to 1.6 pct y/y in Nov-Ifax*, REUTERS, Dec. 22, 2008, <http://in.reuters.com/article/asiaCompanyAndMarkets/idINLM39976220081222>.

23. See Ben Aris, *Russia 2009: Paused before a Rally*, BUS. NEW EUROPE, Dec. 20, 2008, available at [http://businessneweurope.eu/story1414/RUSSIA\\_2009\\_Paused\\_before\\_a\\_rally](http://businessneweurope.eu/story1414/RUSSIA_2009_Paused_before_a_rally) (assuming the price of oil to be \$50 per barrel).

24. RORY MACFARQUHAR, RUSSIA: A SMOOTH POLITICAL TRANSITION 29 (2007), available at <http://www2.goldmansachs.com/ideas/brics/book/BRICs-Chapter2.pdf>.

25. Mikhail Sergeev, *Polosa Bezdokhodnosti*, NEZAVISIMAYA GAZ. (Russ.), Dec. 22, 2008, <http://www.ng.ru/printed/220335>.

26. *Russia's Industrial Production Down in November*, ROSBUSINESSCONSULTING (Russ.), Dec. 15, 2008, <http://www.rbcnews.com/free/20081215183857.shtml>.

commodities prices.”<sup>27</sup> The chief sources of Russia’s acute sensitivity to the 2008 crisis will be discussed below.

FDI inflows to the Russian economy also have accelerated, growing from an average three billion dollars per year from 1998 to 2002<sup>28</sup> to approximately twenty-eight billion dollars in 2007.<sup>29</sup> In late 2008, however, this trend reversed, when FDI fell 2.3 percent to \$19.2 billion.<sup>30</sup> The decline in FDI during 2008 was “mainly due to a drop of FDI in extraction industries, accounting for about half of FDI in 2007.”<sup>31</sup> Significantly, the drop in FDI to extractive industries began in the first half of 2008, before the financial crisis erupted and oil prices imploded.<sup>32</sup>

Even after the recent increases, FDI still plays a relatively small role in Russia’s economy, and accumulated FDI comprised only 10.9 percent of GDP in 2007.<sup>33</sup> Russia’s cumulative FDI inflows from 1990-2006 are near the bottom of “all 28 countries of the transition region.”<sup>34</sup>

Indeed, Russia’s economic recovery has been largely “investment-free . . . thanks to the country’s extensive Soviet-era infrastructure and underutilized capacity.”<sup>35</sup> Nonetheless, investment has in recent years “join[ed] consumption as a pillar of growth.”<sup>36</sup> Much of the FDI entering Russia is limited to certain sectors and certain partners.<sup>37</sup> For example, 49 percent of Russia’s FDI inflow is into the mining and quarrying sectors and two-thirds is from Cyprus and the Netherlands, which likely results from domestic

27. U.S. Department of State, Out of Date Background Notes - Russia (09/07), <http://www.state.gov/outofdate/bgn/r/92546.htm> (last visited Mar. 26, 2009).

28. ECONOMIST INTELLIGENCE UNIT, *supra* note 5, at 173.

29. FED. STATE STATISTICS SERV., FOREIGN INVESTMENTS IN THE ECONOMY OF RUSSIAN BY TYPES (2008), *available at* [http://www.gks.ru/bgd/regl/b08\\_06/IssWWW.exe/Stg/d030/14-06.htm](http://www.gks.ru/bgd/regl/b08_06/IssWWW.exe/Stg/d030/14-06.htm).

30. *Foreign Investment in Russia Shrinks*, RosBUSINESSCONSULTING (Russ.), Nov. 19, 2008, <http://www.rbcnews.com/free/20081119104816.shtml>.

31. WORLD BANK, RUSSIAN ECONOMIC REPORT NO. 17, at 12 (2008), *available at* [http://siteresources.worldbank.org/INTRUSSIANFEDERATION/Resources/rer17\\_eng.pdf](http://siteresources.worldbank.org/INTRUSSIANFEDERATION/Resources/rer17_eng.pdf).

32. *See id.*

33. *See* ECONOMIST INTELLIGENCE UNIT, *supra* note 5, at 221 (table summarizing inward FDI as a percent of GDP of world economies, including those of Brazil, India, and China).

34. *Id.* at 173 (using “transition region” to refer to Eastern Europe).

35. MACFARQUHAR, *supra* note 24, at 34.

36. Pekka Sutela, *Economic Growth Remains Surprisingly High*, 38 RUSS. ANALYTICAL DIG. 2, 3 (2008). Russia’s initial recovery primarily was fueled by a cheap ruble and high oil and gas prices. Nevertheless, Russia’s continuing growth and development is an investment-fueled expansion. *See id.*

37. *See id.* (stating “the volume of investment is not sufficient and it is excessively concentrated in a few branches of the economy”).

firms reinvesting their own capital that is held abroad.<sup>38</sup> If these dubious “foreign” investments are discounted, Russia’s inward FDI in 2007 was \$9.5 billion—much less than the \$27.8 billion reported by the government.<sup>39</sup>

Also, the recent growth in FDI “does not necessarily reflect a radical change in investors’ perceptions of the business climate.”<sup>40</sup> Indeed, a 2005 survey found that, among direct investors, “there is widespread apprehension, and uncertainty as regards the future, in key areas of the operating environment.”<sup>41</sup>

And while Russia’s investment climate has not improved, many argue that “[m]ore international investment is needed to support Russia’s economic development and diversification.”<sup>42</sup> The productivity gains experienced in the recovery period were mostly based on under-utilized capacity and increased investment will be necessary to raise productivity levels in the future.<sup>43</sup> As Russia’s economy “has returned to its pre-transition magnitude in real terms . . . infrastructure bottlenecks have begun to appear.”<sup>44</sup>

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38. See Kari Liuhto, *Russian Tycoons are Russia’s Largest Foreign Investors*, NEW EUROPE, Aug. 25, 2008, available at <http://www.neurope.eu/articles/89405.php>. This phenomenon, known as “round tripping,” is a common way for domestic investors to take advantage of tax and other incentives intended for foreign investors. See, e.g., Rohit Sachdev, Note, *Comparing the Legal Foundations of Foreign Direct Investment in India and China: Law and the Rule of Law in the Indian Foreign Direct Investment Context*, 2006 COLUM. BUS. L. REV. 167, 175-76 (2006) (describing the process through which Chinese companies “export capital to their subsidiaries in Hong Kong or Macao, which then “re-invest” that Chinese capital back into China in order to benefit from tax breaks and other financial incentives accorded only to foreign investors.”).

39. Vladimir Milov, *Bum, Kotorogo Net*, GAZETA.RU (Russ.), June 16, 2008, <http://www.gazeta.ru/column/milov/2755333.shtml>. Milov adds that \$4 billion of the truly “foreign” FDI went into real estate, financial services, construction, and trade, leaving only \$5.5 billion for FDI in the modernization of production capacities and infrastructure.

40. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], OECD INVESTMENT POLICY REVIEWS – RUSSIAN FEDERATION: ENHANCING POLICY TRANSPARENCY 17 (2006) [hereinafter OECD, RUSSIAN INVESTMENT POLICY].

41. NAT’L COUNCIL ON CORPORATE GOVERNANCE, THE RUSSIAN INVESTMENT CLIMATE: INVESTOR PERCEPTIONS IN LONDON, NEW YORK, AND MOSCOW 16 (2005) (reporting that surveyed investors expressed a number of common concerns, including lack of confidence in the rule of law, bureaucracy and corruption, lack of administrative uniformity and predictability, and an uncertain policy environment).

42. OECD, RUSSIAN INVESTMENT POLICY, *supra* note 40, at 10.

43. WORLD BANK, RUSSIAN ECONOMIC REPORT – No. 15, at 13 (2007), available at [http://siteresources.worldbank.org/INTRUSSIANFEDERATION/Resources/rer15\\_En.ver.pdf](http://siteresources.worldbank.org/INTRUSSIANFEDERATION/Resources/rer15_En.ver.pdf). Investment will increase productivity not only through increases in the physical productive capacity, but also through the introduction of new technologies and management methods that increase labor efficiency. See *id.*

44. MACFARQUHAR, *supra* note 24, at 34. As Russia reaches and surpasses its pre-collapse level of gross domestic product (GDP), its existing productive capacity will become overtaxed and its need for investment will grow. *Id.*

Although investment has increased substantially over the past eight years, Russia's economy "continues to require sizeable investments for purposes of diversification and post-Soviet modernization of infrastructure."<sup>45</sup>

The 2008 global financial crisis highlighted some key flaws in Russia's current economic development path and confirmed the need for more FDI.<sup>46</sup> The first major flaw is Russian firms' overreliance on foreign credit to finance their growth.<sup>47</sup> Indeed, Russia's exposure to the crisis was not due to a lack of foreign investment overall, but from overexposure to "other" foreign credits and FPI.<sup>48</sup> In 2007, "other" credits and FPI constituted 77 percent of all foreign investment entering Russia.<sup>49</sup> By 2008, Russian firms had taken advantage of over \$272 billion in foreign loans and other credits as "the primary means . . . to fund major expansions."<sup>50</sup> Ironically, many foreign lenders were able to call in these loans early due to the incredible drop in the Russian stock market, itself 70-80 percent foreign-owned.<sup>51</sup> Most importantly, in 2008, "other" investments and FPI dropped 17.2 percent and 16.3 percent respectively, while FDI fell only 2.3 percent.<sup>52</sup>

45. BANK OF FINLAND INST. FOR ECONOMIES IN TRANSITION [BOFIT], BOFIT FORECAST FOR RUSSIA 2008-2010, at 1 (2008), available at <http://www.bofi.fi/NR/rdonlyres/DA32362B-4168-4CC8-93D7-56E5AA0D4B7E/0/brf208.pdf>.

46. See Greg White, *The Russian Economy is Turned Inside Out*, WALL ST. J., Dec. 21, 2008, available at <http://online.wsj.com/article/SB122969551132221545.html>. This argument holds true even though the crisis affected virtually every country, including those with high levels of FDI.

47. See Owen Matthews, *Out of Pocket*, NEWSWEEK, Nov. 1, 2008, available at <http://www.newsweek.com/id/166913>.

48. MENSHIKOV, *supra* note 15, at 335. Why these types of foreign investment are worse than FDI will be discussed later in the Note.

49. FED. STATE STATISTICS SERV., *supra* note 29, tbl. 24.9.

50. *Geopolitical Diary: Russia's Stock Market Woes*, STRATFOR, Sept. 17, 2008, available at [http://www.stratfor.com/memberships/123838/geopolitical\\_diary/20080916\\_geopolitical\\_diary\\_russias\\_stock\\_market\\_woes](http://www.stratfor.com/memberships/123838/geopolitical_diary/20080916_geopolitical_diary_russias_stock_market_woes); *accord Russia's Foreign Debt Grows 48% to \$460 bln in 2007*, RIA NOVOSTI (Russ.), Apr. 7, 2008, <http://en.rian.ru/russia/20080407/103938437.html> (noting that private sector foreign debt grew 56 percent from 2006 to 2007 and amounts to a little over half of total private sector debt).

51. See Paul Whitfield, *On the QT*, DEAL NEWSWEEKLY, Nov. 14, 2008, available at <http://www.thedeal.com/newsweekly/features/on-the-qt.php>; *More Economic Gloom Predicted*, ROS-BUSINESSCONSULTING (Russ.), Oct. 23, 2008, [http://top.rbc.ru/english/index.shtml?news/english/2008/10/23/23133623\\_bod.shtml](http://top.rbc.ru/english/index.shtml?news/english/2008/10/23/23133623_bod.shtml). The stock market crash affected companies that secured their debt with share prices. See *id.* Thus, when foreign portfolio investors fled the Russian stock market, the resulting declines in share prices triggered contractual options in the loan agreements that allowed the same foreign investors to call in their loans. See *id.*

52. See *Foreign Investment in Russia Shrinks*, *supra* note 29.

For the purposes of this Note, it must be pointed out that Russia's overreliance on foreign credits was the intended result of a specific policy.<sup>53</sup> The policy consisted of: onerously taxing the foreign (for instance, Western) sales of Russian oil producers; lending those tax revenues to Western governments through the purchase of, for example, treasury bills; raising Russia's credit rating due to the accumulation of those reserves; and, based on that credit rating, lending of funds by Western institutions to Russian enterprises, "including those that had earned them in the first place."<sup>54</sup> The Russian government's reasons for this circuitous method were the insufficient domestic banking system, lack of trust in the ability of Russian enterprises to allocate capital efficiently, and the assumption that Western banks could provide "financial intermediation on the basis of market principles rather than connections and corrupt practices."<sup>55</sup> Unfortunately, even if the Western lenders actually made wiser allocations, the money did not end up in the high-impact areas that could have provided a foundation for a more modern, diversified economy.<sup>56</sup> These areas—science and innovation; entrepreneurship and leadership; small business; and infrastructure—went largely untouched by Western banks and, despite ambitious plans, the Russian government was too focused on accumulating reserves and too confident in the stability of high oil prices.<sup>57</sup>

This reveals the second flaw in Russia's development model: the excessive reliance on commodities prices, with oil and gas alone constituting 25 percent of GDP and 75 percent of exports.<sup>58</sup> When the global financial crisis spread to the real world economy, it cripp-

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53. See Clifford G. Gaddy & Barry W. Ickes, *Putin's Third Way*, NAT'L INTEREST ONLINE, Jan. 6, 2009, <http://www.nationalinterest.org/Article.aspx?id=20496>. The issue is relevant here because it demonstrates how foreign investment policies can dramatically impact the economy, in this case negatively.

54. *Id.*

55. *Id.* (explaining further that "Russia was, in effect, paying the West to provide a service").

56. See Yuri Mamchur, *Russia's Economic Crisis Could Have Been Avoided*, SEATTLE TIMES, Dec. 30, 2008, available at [http://seattletimes.nwsource.com/html/opinion/2008573115\\_opin31mamchur.html](http://seattletimes.nwsource.com/html/opinion/2008573115_opin31mamchur.html) ("Russia doesn't have much to show for its meteoritic economic rise and fall, unless you count Moscow's empty nightclubs that used to charge \$40,000 for table service.").

57. See *id.*

58. Comment: *Looking Beyond the Credit Crisis*, BUS. NEW EUROPE, Dec. 19, 2008, available at [http://www.businessneweurope.eu/story1412/COMMENT\\_Looking\\_beyond\\_the\\_credit\\_crisis](http://www.businessneweurope.eu/story1412/COMMENT_Looking_beyond_the_credit_crisis).

pled demand for oil, and prices fell dramatically.<sup>59</sup> And even though Russia possesses sufficient foreign currency and other reserves to prevent a fiscal crisis, lower oil prices “will affect investments quite dramatically.”<sup>60</sup>

Russia is also showing signs of “Dutch Disease”—“a dramatic appreciation of the real exchange rate of the ruble . . . that undermine[s] the growth of all industries except for those in the resource sector.”<sup>61</sup> In addition to the exchange rate issue, “[g]reater reliance on primary resource sectors is associated with greater volatility of growth, and volatility of growth tends to be associated with lower rates of long-run growth.”<sup>62</sup> Thus, when commodity prices collapsed in fall 2008, Russia lost both a source of income for social investments as well as a source of stability for foreign investors and the general population.<sup>63</sup> While this loss of income will force the delay of desperately-needed investments in health, education, and transportation, the loss of stability could weaken the social bases for economic growth.<sup>64</sup>

The 2008 crisis’ severe impact on Russia underscores the country’s need to address the flaws in its development path. One possible policy for this goal would be to promote FDI over other forms of foreign investment and into industries other than natural resource extraction.<sup>65</sup> As described above, “other” foreign investment and FPI immediately fled Russia after the crisis began, and compounded the problem by crashing the stock market and pushing down the ruble.<sup>66</sup> In contrast, FDI inflows slowed modestly and

59. See *As Demand Outlook Dims, Oil Slides*, ASSOCIATED PRESS, Dec. 22, 2008, available at <http://www.msnbc.msn.com/id/12400801>.

60. See *Comment: Looking Beyond the Credit Crisis*, *supra* note 58.

61. Vladimir Popov, *After 10 Years of Growth, the Russian Economy May Be Losing Steam*, 48 *RUSS. ANALYTICAL DIG.* 15, 17 (2008). Greater exchange rate volatility also presents risks that discourage long-term foreign investment. See *id.*

62. Rudiger Ahrend, Donato de Rosa & William Tompson, *Russian Manufacturing and the Threat of “Dutch Disease”* 7 (OECD Econ. Dep’t., Working Paper No. 540, 2006), available at <http://ideas.repec.org/p/oec/ecoaaa/540-en.html>.

63. See Gregory L. White, *Oil’s Drag on Russian Growth Poses Test for Putin*, WALL ST. J., Oct. 18, 2008, available at <http://online.wsj.com/article/SB122428427371546367.html>.

64. But see *Social Spending a Priority Despite Crisis*, ROSBUSINESSCONSULTING (RUSS.), Dec. 12, 2008, <http://www.rbcnews.com/komment/komment.shtml?2008/12/19/32250153>. The panic and uncertainty that accompany such a sudden economic reversal might negatively influence the calculated risk-taking, creativity, and goal-seeking behaviors that characterize an innovative and dynamic society.

65. WORLD BANK, *supra* note 31, at 21. While it is theoretically “easy” to limit other forms of foreign investment (i.e., very strict capital controls), this does not mean that FDI will proportionately increase. Even more difficult is how a state is supposed to steer FDI into desired industries without limiting the freedom demanded by foreign investors.

66. See *id.* at 10-11.

existing FDI projects continued to work.<sup>67</sup> Indeed, the trend is that FDI is significantly more stable than FPI and other foreign investments.<sup>68</sup> FDI could help Russia diversify its economy and reduce its reliance on commodity prices if that investment increases the share of non-extraction industries and enhances the role of technology and the high-tech sector.<sup>69</sup> In this way, the 2008 crisis dramatically illustrated why, with regards to foreign investment, Russia should perhaps attempt to promote FDI and even limit foreign lending and FPI.

Though FDI generally remains a popular idea in the West and, to a lesser extent, Russia, scholars have expressed skepticism over FDI's alleged benefits. For example, some observers point to the fact that the benefits of FDI are relative to the presence of certain factors, such as "the utilization of international capital as a secondary source of enterprise capital formation, after national savings; the use of FDI predominantly for innovation purposes; and a situation in which foreign investors have truly long-term interests in the recipient country."<sup>70</sup> Navoi further argues that for several East European countries, the experience with FDI caused them "to lose a considerable share of their economic sovereignty and to become 'assembly shops' for major European concerns."<sup>71</sup> Navoi also takes issue with the international practice of "reinvesting" profits from a foreign direct investment into a business and recording them as "new" FDI, just as if some new investor arrived to the country and made an initial investment.<sup>72</sup> In the context of a profitable firm, this practice yields earnings to the foreign investor. Those earnings are automatically reinvested and treated as an influx of FDI, even though the money never leaves the firm's balance sheet.<sup>73</sup> Also, Navoi asserts that the majority of real FDI is in the form of acquisitions, which are "often used by large multinational corpora-

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67. See, e.g., Maria Antonova, *Medvedev Warms Up at GM Plant Opening*, MOSCOW TIMES, Nov. 10, 2008, available at <http://www.themoscowtimes.com/articles/detail.php?ID=372214&pr>.

68. Anil Kumar, *Does Foreign Direct Investment Help Emerging Economies?*, ECON. LETTER (Fed. Reserve Bank of Dallas, Dallas, TX), Jan. 2007, at 3, available at <http://www.dallasfed.org/research/eclett/2007/el0701.pdf>.

69. See INST. FOR THE ECON. IN TRANSITION, *RUSSIAN ECONOMY IN 2007: TRENDS AND OUTLOOKS* 52 (2008), available at <http://www.iel.ru/en/russian-economy-in-2007-trends-and-outlooks-issue-29-2.html>.

70. A. Navoi, *Foreign Direct Investment: An Indirect Path to the Economy*, 51 PROBS. ECON. TRANSITION 81, 83 (2008).

71. *Id.*

72. *Id.* at 87.

73. *Id.*

tions not in order to expand business in the country in question, but to get rid of a competitor.”<sup>74</sup> As a response to these issues, Navoi suggests that “there is an urgent need to devise a special-purpose program to monitor FDI” that seeks to attract FDI, prioritize certain sectors, and analyze the effectiveness of FDI.<sup>75</sup>

A similar review of FDI in post-communist countries also found that the benefits are not apparent, and that some countries develop a “dual economy structure characterized by a strong dependence on foreign capital but weak indigenous efforts.”<sup>76</sup> In her broad survey of the literature on FDI, Camilla Jensen found that the findings are ambiguous regarding the link between FDI and economic growth.<sup>77</sup> Still, Jensen also observed that “FDI rarely produces a negative outcome for economic growth on its own,” and that the policy efforts associated with promoting FDI are inherently beneficial for the host country.<sup>78</sup>

As if to mirror the academic debate over foreign investment, members of Russia’s ruling elite similarly disagree about what policy the country should pursue. Usually, debates over strategic policies pit economic nationalists from the security services against economic internationalists from the economics and finance ministries.<sup>79</sup> Nonetheless, the current Russian government recognizes the need for foreign investment, and promotes FDI as its official policy, albeit not at any cost.<sup>80</sup>

74. *Id.* at 88.

75. *Id.* at 95 (describing “effectiveness” as “the share of foreign investment to be earmarked for modernization of the controlled enterprise’s fixed assets, changes in labor productivity . . . the state of competition in the sector, and the share of profit to be sent abroad”).

76. Camilla Jensen, *Foreign Direct Investment and Economic Transition: Panacea or Pain Killer?*, 58 EUR.-ASIA STUD. 881, 881 (2006). This is particularly a feature of governments that “expected FDI to do most of the job of getting their country on the road to prosperity.” *Id.* at 882. This is similar to how Russia viewed the use of foreign lenders before the current crisis.

77. *Id.* at 895.

78. *Id.* at 897.

79. See, e.g., Tim Gosling, *39 Steps Down for the Cabinet’s Liberal Faction?*, BUS. NEW EUROPE, July 20, 2007, available at <http://www.russiaprofile.org/page.php?pageid=business&articleid=A1184930779>. Those from the security services are known as *siloviki* (literally, the power people) and are arguably opposed to most forms of foreign investment, especially that which results in foreign control of large Russian companies. See Ian Bremmer & Samuel Charap, *The Siloviki in Putin’s Russia: Who They Are and What They Want*, WASH. Q., Winter 2006-07, at 83, 89, available at [http://www.twq.com/07winter/docs/07winter\\_bremmer.pdf](http://www.twq.com/07winter/docs/07winter_bremmer.pdf). Western commentators, however, tend to exaggerate the power of the *siloviki* and diminish the influence of economic liberals in the Russian government. See *id.*

80. See *President Welcomes Foreign Investment*, *supra* note 7.

Russian President Dmitry Medvedev falls into the economic globalist school to an even greater extent than Prime Minister Putin.<sup>81</sup> President Medvedev has stressed that Russia's development strategy should be guided by the "four I's"—"Institutions, Infrastructure, Innovation, Investment."<sup>82</sup> Of even greater significance is that Russia's new 2020 National Security Strategy—which Putin started and Medvedev finished—is explicitly based on the assumption that "stable national development and the provision of national security are interlinked."<sup>83</sup> In other words, Medvedev's goal is not so much to try and balance between embracing foreign investment and promoting national security, which is a false choice. Rather, his objective is to devise and follow a strategy under which several national priorities will complement, rather than compete with, one another.<sup>84</sup>

Regardless of FDI's role, Russia lacks many of the technical and social elements necessary to support the innovative economy envisioned by President Medvedev's security strategy.<sup>85</sup> Indeed, to achieve the improvements in living standards envisioned by the 2020 strategy, "productivity would have to increase by 2.5 times . . . , the energy intensity of production decline by 55 to 60 percent, and spending on research and development increase" 300 percent by 2020.<sup>86</sup> Also, as discussed above, Russia is rapidly approaching a ceiling of economic expansion, as its recent growth has pushed Soviet-era infrastructure to the limit.<sup>87</sup>

One example of an area where Russia desperately needs investment—both foreign and domestic—is in its power grid. Until recently, Russia's power grid was administered by the state monopoly, Unified Energy System (UES), which controlled "580,000

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81. *See Medvedev Seen as Friendly to Business in Russia*, INT'L HERALD TRIB., Dec. 10, 2007, available at <http://www.nytimes.com/2007/12/10/business/worldbusiness/10iht-trtrrubble11.8675965.html>.

82. *See Medvedev Says 'Four I's Key' to Russia's Economic Program*, RIA NOVOSTI (Russ.), Feb. 15, 2008, <http://en.rian.ru/russia/20080215/99277106.html>.

83. Nikolai Patrushev, Russ. Fed. Sec. Serv. Sec'y, Speech at Beginning of Meeting with Security Council on National Security Strategy of the Russian Federation Through to 2020 and Measures Necessary to Implement It (Mar. 24, 2009) (transcript available at [http://www.kremlin.ru/eng/text/speeches/2009/03/24/2056\\_type82913\\_214288.shtml](http://www.kremlin.ru/eng/text/speeches/2009/03/24/2056_type82913_214288.shtml)).

84. *See id.* (observing that such priorities "include national defence, state and public security, as well as the constant improvement of people's quality of life, economic growth, science, technology, education, public health and culture, ecology and the rational management of natural resources, strategic stability and equitable strategic partnership").

85. *See generally* ANDERS ASLUND & ANDREW KUCHINS, THE RUSSIA BALANCE SHEET 42-43 (2009).

86. *Id.* at 43.

87. *See id.* at 47.

workers, 440 power stations, and 2 million miles of power lines.”<sup>88</sup> Despite these impressive resources, the company was unable to meet increasing demand, even in the city of Moscow, which faced a huge energy deficit in the cold winter of 2006.<sup>89</sup> For this reason, the country has a pressing “need to attract massive amounts of foreign investment—around \$100 billion between [2007] and 2010—to renovate Russia’s crumbling electricity infrastructure.”<sup>90</sup> Furthermore, the hope is not only to obtain access to money, “but also [to] promote economic efficiency and transparency.”<sup>91</sup> Reform is currently underway, and “UES is selling all of its assets to raise funds for a \$125 billion overhaul of Russia’s power systems and to open the sector to free competition for the first time.”<sup>92</sup> The strategy appears to be working—in March 2008, Electricité de France and a Russian partner announced plans to acquire one of UES’s major utilities.<sup>93</sup> This UES example likely is similar to the situation with the rest of Russia’s infrastructure, including pipelines,<sup>94</sup> railways,<sup>95</sup> seaports,<sup>96</sup> and airports.<sup>97</sup> Some Russian officials have argued that inadequate infrastructure has contributed to the overheating of the economy because the demand from new enterprises placed on, for example, electricity, exceeds the supply available

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88. Jason Bush, *Electric Shock in Russia*, BUS. WK., Mar. 22, 2007, available at [http://www.businessweek.com/globalbiz/content/mar2007/gb20070322\\_230020.htm](http://www.businessweek.com/globalbiz/content/mar2007/gb20070322_230020.htm).

89. See *Moscow Mayor Says Winter Energy Deficit Could Reach 20%*, RIA NOVOSTI (Russ.), Sept. 5, 2006, <http://en.rian.ru/russia/20060905/53517839.html>.

90. Bush, *supra* note 88.

91. *Id.*

92. *Russian Grid Companies to List Shares this Year*, REUTERS, Feb. 22, 2008, <http://www.reuters.com/article/rbssIndustryMaterialsUtilitiesNews/idUSL2244716520080222>. The company itself—a household name in Russia for the last sixteen years—actually ceased to exist as of July 2008. See *id.*

93. Alfred Kueppers, *EDF, TransNeftServis-S to acquire UES’s OGG-1 utility*, FORBES, Mar. 27, 2008, <http://www.forbes.com/afxnewslimited/feeds/afx/2008/03/27/afx4819887.html>. The utility is reportedly worth \$7 billion. See *id.*

94. See Pat Davis Szymczak, Sergei Korobov, & Vlad Konstanza, *Russia Gas Tap Turns to China*, OIL & GAS EURASIA, June 2006, available at <http://www.oilandgaseurasia.com/articles/p/9/article/167> (arguing that “whether Russia looks East or West, it needs big investment to grow its production and to transport that production reliably to market”).

95. See World Bank, *Transport – Russia*, <http://go.worldbank.org/SGG4WO6750> (last visited Mar. 26, 2010) (“The Russian economy is more rail-dependant than any other large country in the world . . . [and now there] is an urgent need to restructure the rail system . . .”).

96. See *id.*

97. See Bojan Soc, *MAI: Ulan Ude Airport Holds Huge Potential*, MOSCOW NEWS, Apr. 4, 2007, <http://www.mnweekly.ru/business/20071004/55280527.html> (“A recent survey by AT Kearney found that Russia’s air traffic will grow at an annual rate of more than 6 percent. This fact alone is undoubtedly a huge draw for investors looking to upgrade its aging airports and bring the existing infrastructure there in line with global aviation standards.”).

from the power grid.<sup>98</sup> Indeed, because an “economy depends on infrastructure to facilitate the flow of goods, people, information and energy,” poor infrastructure can increase costs and cripple the economy.<sup>99</sup> In Russia’s case, “investment is needed . . . for repairing deficiencies in infrastructure.”<sup>100</sup>

### B. *Existing Legal and Regulatory Framework*

The major law governing the rights and protections of foreign investors in Russia is entitled “On Foreign Investment in the Russian Federation” of July 1999.<sup>101</sup> The law is the “core legislation governing the national regime of foreign investments in Russia.”<sup>102</sup> Article 2 of the law includes five entities under the definition of “foreign investor”—foreign citizens, stateless persons residing outside of Russia, foreign judicial persons (for example, corporations), foreign organizations that are not judicial persons (for example, limited liability partnerships), international organizations, and foreign states.<sup>103</sup> Article 2 also defines foreign investment as the “contribution of foreign capital in an object of entrepreneurial activity on the territory of the Russian Federation.”<sup>104</sup> FDI is defined as “the acquisition by a foreign investor of at least 10 per cent stake . . . in the . . . capital of a commercial organization.”<sup>105</sup> Articles 4 through 15 of the law define the various guarantees for foreign investors, which include national treatment (except when federal law provides otherwise),<sup>106</sup> legal

98. *See Lack of Infrastructure Causes Economy to Overheat, Deputy PM Says*, ROSBUSINESSCONSULTING (Russ.), Mar. 31, 2008, <http://www.rbcbnews.com/free/20080331125526.shtml>. Overheating (which is most immediately evidenced by inflation) generally occurs when a quickly-expanding economy’s productive capacity is unable to keep pace with demand. *See id.*

99. Steven H. Hanke, *In Praise of Private Infrastructure*, GLOBE ASIA MAG., Mar. 26, 2008, available at [http://globeasia.com/index.php?module=columnist&action=detail&id\\_selected=78](http://globeasia.com/index.php?module=columnist&action=detail&id_selected=78).

100. HELI SIMOLA, RUSSIAN ECONOMIC GROWTH CALLS FOR INVESTMENT 1 (2007), available at <http://www.bof.fi/NR/rdonlyres/29C2BCE9-5A3B-4B27-9DAD-78A52DA30023/0/focus0707e.pdf>.

101. *See* Vitaly Glinkin, *Investment Climate in Russia*, BUS. RECORDER, June 11, 2007.

102. *Id.*

103. Law on Foreign Investment in the Russian Federation art. 2, No. 160-FZ, July 9, 1999 [hereinafter 1999 Foreign Investment Law].

104. WILLIAM BURNHAM, PETER B. MAGGS & GENNADY M. DANILENKO, LAW AND LEGAL SYSTEM OF THE RUSSIAN FEDERATION 452-53 (2004).

105. 1999 Foreign Investment Law, *supra* note 103, art. 2.

106. National treatment means that a foreign investor is treated the same as a domestic investor, except when the law provides otherwise. *See* National Treatment, Investopedia.com, <http://www.investopedia.com/terms/n/nationaltreatment.asp> (last visited Mar. 26, 2010).

protections, right to effectuate investment, the ability to transfer rights and duties to another party, the guarantee of compensation in the event of nationalization, and the right to transfer out earnings and profits.<sup>107</sup> Significantly, several provisions (for example, Article 4, Section 2) provide for restrictions based on the “protection of fundamental constitutional principles, morality, health, or the rights and legal interests of others, or to provide for the defense of the country and security of the state.”<sup>108</sup> When the law was passed, some observers raised concerns with these caveats and indicated that “it remains to be seen how the Russian government might use such broad ‘Public Policy Grounds’ to erode the protections that Foreign Investors presently enjoy.”<sup>109</sup> The law’s provisions granting national treatment and the right to transfer out capital make for a liberal legal framework for foreign investment in Russia.<sup>110</sup> In many respects, however, “the 1999 Law is little more than a broad statement of principles.”<sup>111</sup> A multitude of other laws often supplement the Foreign Investment Law in regulating the activity of investors.<sup>112</sup> Lastly, “there are many restrictions on foreign investment in the armaments industry . . . exploration and exploitation of certain natural resources, transportation and ownership of land.”<sup>113</sup> Thus, while “Russia has made an effort to establish the basic elements of a relatively liberal investment regime,” an uncertain legal and regulatory environment still hinders the growth of FDI.<sup>114</sup>

### C. *Regulatory Environment in Practice*

Russia’s liberal foreign investment law and pronouncements in support of FDI often contrast with the policy environment in practice. Generally, “[i]nformal barriers to foreign investment in Russia are still considered to be a serious impediment to new

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107. See 1999 Foreign Investment Law, *supra* note 103, arts. 4-15.

108. *Id.*

109. Mark S. Vecchio & Peter Chessick, *The New Russian Foreign Investment Law: Old Wine in New Bottles?*, RUSS. AM. CHAMBER COM. NEWSLETTER, Sept. 8, 1999, available at [http://www.russianamericanchamber.org/newsletter/new\\_russian\\_investment\\_law.html](http://www.russianamericanchamber.org/newsletter/new_russian_investment_law.html).

110. See 1999 Foreign Investment Law, *supra* note 103, arts. 2, 4-15.

111. BURNHAM, MAGGS & DANILENKO, *supra* note 104, at 451.

112. See *id.* (referring to particularly the Law on Investment Activity in the Russian Soviet Federative Socialist Republic (RSFSR), the Civil Code, and laws on “stock companies, monopolies, securities, banking taxation, privatization, land and natural resources, environmental protection, labor, foreign exchange, foreign trade and export control”).

113. *Id.* at 454.

114. *Id.* at 464.

investments.”<sup>115</sup> Indeed, “[c]orruption, administrative barriers, bureaucracy . . . , red tape . . . , and selective interpretation of laws continue to cast a dark shadow on Russia’s investment climate and its global competitiveness.”<sup>116</sup> A recent World Bank study found that, in order to obtain a license to build a warehouse, an investor must complete fifty-four procedures over a period of 704 days.<sup>117</sup> With regard to the court system, foreign firms “are mainly dissatisfied with a perceived lack of uniformity and impartiality and especially with the insufficient rapidity and effectiveness” of the courts.<sup>118</sup> Recently, there have also been growing concerns regarding undue interference from the security services in Russian business.<sup>119</sup> For example, in March 2008, agents from the Federal Security Service (FSB) raided British Petroleum’s (BP’s) Moscow offices.<sup>120</sup> The agents were reportedly searching for documents pertaining to Gazprom, the state-owned natural gas monopoly.<sup>121</sup> Analysts interpreted the raid “and the subsequent arrest of an employee of TNK-BP on suspicion of industrial espionage, as a sign the Kremlin is stepping up pressure on TNK-BP and its owners.”<sup>122</sup> Although most investors did not think that the Russian government would expropriate TNK-BP, many concluded that the pressure on the company “may force [TNK-BP] . . . to cede control of Russia’s third-largest oil producer to state-backed Rosneft or Gazprom before long.”<sup>123</sup> Most recently, since TNK-BP CEO Robert Dudley was forced to leave Russia after authorities denied his visa

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115. ROBERT SATROM & DMITRY ZHDANOV, HOGAN & HARTSON LLP MOSCOW, FOREIGN INVESTMENT IN RUSSIA: REFORM AND RE-REGULATION (2006), available at [http://barentsnova.com/files/attachments/0000/0630/foreign\\_investment.doc](http://barentsnova.com/files/attachments/0000/0630/foreign_investment.doc).

116. PBN CO., RUSSIA INVESTMENT DESTINATION 2006, at 7 (2006), available at [http://www.pbnco.com/fiacsurvey2006/2006\\_FullReport\\_Eng.pdf](http://www.pbnco.com/fiacsurvey2006/2006_FullReport_Eng.pdf).

117. See WORLD BANK, DOING BUSINESS 2008: RUSSIA 12 (2007).

118. OECD, RUSSIAN INVESTMENT POLICY, *supra* note 40, at 27.

119. See, e.g., LILIA SHEVTSOVA, RUSSIA: LOST IN TRANSITION 102 (2007) (“Corruption and criminal activity by representatives of the Interior Ministry, the [Federal Security Service] (FSB), the Tax Department, and the prosecutor’s office beggar belief.”).

120. See CONOR SWEENEY & DMITRY ZHDANNIKOV, *Agents ‘Hunted Gazprom Documents’ in BP Russian Raids*, REUTERS, Apr. 2, 2008, <http://www.reuters.com/article/ousivMolt/idUSL0251333720080402>.

121. See *id.*

122. *Id.* TNK-BP is the joint venture between British Petroleum (BP) and several Russian billionaires. See *id.* It is the single largest British investment in Russia. A tax evasion investigation was also opened. See *id.* Later, reporting suggested that the “flurry of negative activity” resulted from a feud between the Russian billionaires who own 50 percent of the joint venture. See *id.* In either case, the FSB’s role clearly was not benign. See Miriam Elder, *TNK-BP Woes Might Be Inside Job*, MOSCOW TIMES, Apr. 11, 2008, available at <http://www.themoscowtimes.com/stories/2008/04/11/002.html>.

123. Tom Bergin, *BP May Have to Give Up Control of Russia Venture*, GUARDIAN (U.K.), Apr. 4, 2008.

application, he accused various government agencies of abusing their power in dealing with the company.<sup>124</sup>

Another example of the erratic investment environment in Russia that received much media attention was the case of Motorola's missing phones.<sup>125</sup> In March 2006, the Interior Ministry of Russia seized 167,000 mobile phones from Motorola at the Sheremetyevo Airport in Moscow.<sup>126</sup> The ministry "provided a series of shifting reasons, saying first that the phones were counterfeit, then contraband, then a health hazard and finally evidence in a criminal corruption case that has, evidently, since been dropped."<sup>127</sup> The ministry later returned 117,519 phones without an explanation for the seizure or what happened to the other 50,000 phones.<sup>128</sup> Eventually, the authorities reported that the 50,000 handsets had been "destroyed," though investigators began to look into whether they actually had been sold on the black market.<sup>129</sup> Commentators argued that the Motorola ordeal was symptomatic of the general level of corruption and unfairness afflicting businesses operating in Russia.<sup>130</sup>

#### D. *The Strategic Sectors Law*

##### 1. Why a Strategic Sectors Law?

Russian authorities first suggested the Strategic Sectors Law in 2005, "when the German corporation Siemens attempted to buy a major stake in Russia's *Silovye Mashiny* [Power Machines]," which revealed a gap in the Russian legislation governing foreign investors.<sup>131</sup> The Siemens fiasco began in 2004-2005 when that company sought to acquire Russian company Interros's shares of Power Machines, which would have given Siemens a 74 percent share in

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124. See Will Bland, *TNK-BP CEO Alleges Abuse of Power*, WALL ST. J., Aug. 23, 2008, available at <http://online.wsj.com/article/SB121944911068065267.html>.

125. See Steven Lee Myers, *Mobile Phones Seized by Russia Returned to Motorola*, INT'L HERALD TRIB., Aug. 25, 2006, available at <http://www.iht.com/articles/2006/08/25/news/web.0825russia.php>.

126. See *id.*

127. *Id.*

128. See *id.*

129. Andrew E. Kramer, *A New Twist in a Russian Cellphone Caper*, N.Y. TIMES, Oct. 24, 2006, available <http://www.nytimes.com/2006/10/24/business/worldbusiness/24phone.html>.

130. See Steven Lee Myers, *Phone Seizure Seen as Example of Russian Corruption*, N.Y. TIMES, June 16, 2006, available at <http://www.nytimes.com/2006/06/14/world/europe/14russia.html?pagewanted=all>.

131. Alexander Yurov, *Kremlin to Limit Foreigners' Access to Strategic Industries*, RIA NOVOSTI (Russ.), Nov. 27, 2006, <http://en.rian.ru/analysis/20061127/56037837.html>.

the company.<sup>132</sup> In December 2004, however, Basic Element—a corporation owned by Russian billionaire and Kremlin insider Oleg Deripaska—applied to purchase the same stock of Power Machines as Siemens.<sup>133</sup> Soon thereafter, officials publicly came out against the deal and the State Duma adopted a proposal “which said that the sale of [Power Machines] is threatening the defense and economic security of the country.”<sup>134</sup> The Duma deputies based their resolution on Power Machines’ status as a main producer of turbine engines used in military vehicles.<sup>135</sup> The Minister of Industrial Power, Viktor Khristenko, commented on the situation at the time saying, “[T]he main thing . . . is the absence of the legal base for the deal.”<sup>136</sup> The Federal Anti-Monopoly Service (FAS) ultimately denied Siemens’ application on the grounds that the deal’s approval “would lead to limitation of competition in the markets of electric power equipment.”<sup>137</sup> Specifically, the FAS found that the proposed deal would violate the law “On Competition and the Limitation of Monopolistic Activity on Commodity Markets.”<sup>138</sup> The FAS noted that “in the framework of the existing legislation it is impossible to solve problems related to . . . the participation of foreign companies in the manufacture of military goods.”<sup>139</sup> In the aftermath of—literally, days after—the Siemens affair, President Putin addressed the need for a law regulating Russia’s strategic sectors for the first time ever. In his annual address to the Federal Assembly on April 25, 2005, Putin spoke about foreign investors as follows:

In practice, investors sometimes face all kinds of limitations, including some that are explained by national security reasons, though these limitations are not legally formalized. This uncertainty creates problems for the state and investors. It is time we

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132. See Renata Yambaeva, Natalia Grib & Alyona Kornysheva, *Siemens is Not Ready for Defense*, KOMMERSANT (Russ.), Apr. 14, 2005, [http://kommersant.com/p570014/Siemens\\_Is\\_Not\\_Ready\\_For\\_Defense/](http://kommersant.com/p570014/Siemens_Is_Not_Ready_For_Defense/).

133. See *id.*

134. *Id.*

135. *Id.*

136. *Id.* (referring to the failure of current foreign investment law to speak to national security concerns or limit foreign investment on this basis); see also Satrom & Zhdanov, *supra* note 115, at 2 (“There is no single statute or code unifying the treatment of investments across all Russian economic sectors, and to date no single piece of legislation has applied ‘national security’ across the board as an overriding criteria for the approval or disapproval of a particular investment.”).

137. Press-sluzhba FAS Rossii, Federal’naya Antimonopol’naya Sluzhba Otklonila Khodaistvo Kompanii Siemens o Priobretenii OAO Silovye Mashiny, Apr. 12, 2005, *available at* [http://www.fas.gov.ru/news/n\\_1859.shtml](http://www.fas.gov.ru/news/n_1859.shtml).

138. *Id.*

139. *Id.*

clearly determined the economic sectors where the interests of bolstering Russia's independence and security call for predominant control by national, including state, capital . . . . We should draft and legally formalize a system of criteria to determine the limitations on foreign participation in such sectors of the economy. Simultaneously a corresponding list of industries or facilities will be determined that shall not be extended or receive extended interpretation.<sup>140</sup>

Thus, the Strategic Sectors Law arose as a response to the lack of a legal framework for investment in strategically significant Russian companies.

## 2. The Strategic Sectors Law's Status

Although Putin first proposed the idea of a Strategic Sectors Law in 2005, work on the bill did not start until July 2007.<sup>141</sup> During the summer of 2007, various committees reviewed and finalized the bill for its first reading by the Duma on September 13, 2007.<sup>142</sup> Lawmakers and observers had expected the bill to pass its second reading, if not become law, before the end of 2007, but in November, its progress was delayed until the spring of 2008.<sup>143</sup> The delay was likely due to the Duma elections in December 2007 and the Presidential election in March 2008.<sup>144</sup> The second reading of the legislation, which included many changes, passed the State Duma on March 21, 2008.<sup>145</sup> Finally, the legislation passed its third reading on April 2, 2008, it passed the Federation Council a few weeks later, and President Putin signed it into law on May 5, 2008.<sup>146</sup>

## 3. Who is Regulated?

The Strategic Sectors Law regulates two groups of investors. The first group comprises businesses owned or controlled by foreign

140. Putin, *supra* note 10. In other words, Putin advocated a law that would limit the criteria considered and industries affected so that foreign investment would not be subordinated to the whims of the political process.

141. Perechen' Dokumentov dlya Zakonproekta No. 455348-4, available at <http://www.duma.gov.ru/faces/lawsearch/gointer.jsp?c=455348-4> (last visited Sept. 13, 2010).

142. *Id.*

143. See Anatoly Medetsky, *Strategic Sectors Bill Off Until 2008*, MOSCOW TIMES, Nov. 9, 2007, available at <http://www.themoscowtimes.com/stories/2007/11/09/041.html>.

144. See Denis Dyomkin, *Campaigning Starts in Russian Presidential Election*, REUTERS, Feb. 2, 2008, <http://www.reuters.com/article/worldNews/idUSL3011403920080202>.

145. See Gleb Bryanski, *Russia Passes Foreign Investment Law on 2nd Reading*, GUARDIAN (U.K.), Mar. 21, 2008, available at <http://www.guardian.co.uk/feedarticle?id=7402505>.

146. See *Russia's Putin Signs Foreign Investment Law*, REUTERS, May 5, 2008, <http://www.reuters.com/article/reutersEdge/idUSL0514680420080505>. The Federation Council is the upper house of the Russian Duma—roughly equivalent to the U.S. Senate. See generally *Konstitutsiia Rossiiskoi Federatsii* [Konst. RF] [Constitution] arts. 95, 105.

states or international organizations that wish to acquire 25 percent of the shares of a strategic business, 5 percent of strategic subsoil companies having “federal significance” (subsoil companies), or the ability to block decisions of the directors of either type of company.<sup>147</sup> Significantly, these public companies are generally forbidden from acquiring control over any of the types of businesses covered by the legislation.<sup>148</sup> The second group includes organizations controlled by foreign investors that wish to acquire control of a strategic business or subsoil company.<sup>149</sup> The definition of foreign investor is regulated by the existing law on foreign investment.<sup>150</sup> The Foreign Investment Law’s definition of foreign investor includes foreign entities that are entitled under the legislation of their home state to invest in Russia, foreign citizens, and people without citizenship.<sup>151</sup> The law defines control as the ability of a foreign investor to make decisions for the business through various means.<sup>152</sup> Specifically, the indicators that a foreign investor has control include 50 percent ownership of the company’s shares, the right to name 50 percent of the company’s board of directors, or the right of the foreign investor to make decisions for the company or exercise management powers.<sup>153</sup> In the case of subsoil companies, control includes ownership of 10 percent of the company’s shares, the right to name 10 percent of the company’s board of directors, or the right to make management decisions.<sup>154</sup>

#### 4. What is Regulated?

Perhaps the most controversial feature of the Strategic Sectors Law is the list of industries falling under the law’s regulations.<sup>155</sup> Many categories are duplicative and redundant, which results in a list that appears larger than it is in reality. The regulated industries can actually be divided into fifteen spheres. The industries include: the hydrometeorological processes and phenomena industry; the geophysical processes and phenomena industry; the

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147. Strategic Sectors Law, *supra* note 1, art. 2, ¶ 3. The ability to block decisions is defined as the ability to command three-fourths of the votes of directors. *See id.* art. 3, ¶ 1, subsec. 5.

148. *See id.* art. 2, ¶ 2.

149. *See id.* art. 3, ¶ 1, subsec. 3 (defining “control” by a foreign business).

150. *See id.* art. 3, ¶ 2.

151. 1999 Foreign Investment Law, *supra* note 103, art. 2.

152. *See* Strategic Sectors Law, *supra* note 1, art. 3, ¶ 1, subsec. 3. The law applies to foreign investors who exercise control either directly or through third parties. *See id.*

153. *See id.* art. 5, ¶ 1.

154. *See id.* art. 5, ¶ 3.

155. *See, e.g.,* Gosling, *supra* note 79.

infectious diseases and pathogens industry; the nuclear industry; the space industry; the surveillance and encryption industry; the defense industry; the aviation industry; the production of metals and alloys used in military technologies; natural monopolies; telecommunications providers; fisheries; television and radio stations; publishing companies; and the study and extraction of subsoil resources.<sup>156</sup> The television and radio stations covered in the law consist of those that reach at least half of the population.<sup>157</sup> The telecommunications providers that the law regulates include those that occupy a “dominant position” in their respective industries.<sup>158</sup> Regulated publishing companies are also limited to those capable of printing 200 million reproductions per month<sup>159</sup> and periodicals with a distribution of one million copies.<sup>160</sup> Perhaps the most controversial aspect of the list is the inclusion of natural monopolies.<sup>161</sup> Natural monopolies are defined in an existing law and include pipelines, rail transportation, services at sea and airports, and the electricity and heating grids.<sup>162</sup> This legislation exempted several categories of natural monopolies—electricity, heating, and postal services.<sup>163</sup> Then-Minister of Economics German Gref strongly resisted the inclusion of natural monopolies due to the extreme need for investment in those sectors.<sup>164</sup> Indeed, President Putin himself has stressed the need for more foreign investment in infrastructure and has pledged to liberalize those sectors.<sup>165</sup> Some commentators also criticized the inclusion of telecommunications companies on the list, arguing that this would “hamper investment on [sic] the communications market and will no doubt cause stag-

156. See Strategic Sectors Law, *supra* note 1, art. 6 (referring to various industries in enumerated paragraphs).

157. See *id.* art. 6, ¶¶ 34-35.

158. See *id.*, art. 6, ¶ 37. A company holds a “dominant position” in an industry if it possesses a 50 percent market share or if the Federal Anti-Monopoly Service has designated it as holding such a position. See Federal’nyi Zakon O Zashchite Konkurentsii art. 5, ¶ 1, Ros. gaz., July 26, 2006, available at <http://www.rg.ru/2006/07/27/zaschita-konkurencii.html>.

159. See Strategic Sectors Law, *supra* note 1, art. 6, ¶ 41.

160. See *id.* art. 6, ¶ 42.

161. See *id.* art. 6, ¶ 36.

162. See Law on Natural Monopolies art. 4, No. 147-FZ, Aug. 17, 1995, available at <http://base.garant.ru/10104442.htm>.

163. Strategic Sectors Law, *supra* note 1, art. 6, ¶ 36.

164. Gosling, *supra* note 79. At a February 2007 cabinet meeting, Gref reportedly said, “It is wrong to stoop to restricting investments in infrastructure.” See *id.* Gref was replaced during a cabinet shakeup in September 2007. See *id.*

165. See *President Welcomes Foreign Investment*, *supra* note 7.

nation in the industry.”<sup>166</sup> Lastly, the inclusion of newspapers, publishers, and fisheries to the list similarly “raised eyebrows and worried foreign investors.”<sup>167</sup>

## 5. What Are the Procedures?

The Strategic Sectors Law defines the procedures by which an investor can apply for, and the government can examine, a proposed deal. The investor’s application consists of several elements, including the details of the proposed deal, information on the purchasing and target companies, and proof of the applicant’s registration in Russia.<sup>168</sup>

The government’s mechanism for evaluating applications involves two state entities—the Representative Body and the Government Commission on Foreign Investment (Commission).<sup>169</sup> Although the law simply says the Representative Body will be an executive organ, the FAS ended up as the lead agency.<sup>170</sup> The law also defines the FSB’s right to conduct “operational search measures” in order to determine whether an investor has control over a strategic business.<sup>171</sup> The Representative Body’s main functions include: registering the application; establishing whether the appli-

166. Anatoly Medetsky & Tai Adelaja, *Telecoms to Be Included as a Strategic Sector*, MOSCOW TIMES, Mar. 7, 2008, available at <http://www.moscowtimes.ru/article/1009/42/360857.htm> (quoting the Deputy IT and Communications Minister, Alexander Maslov).

167. Taj Adelaja & Natalia Krainova, *Strategic Sectors Bill Clears 2nd Reading*, ST. PETERSBURG TIMES (Russ.), Mar. 25, 2008, available at [http://www.sptimes.ru/index.php?story\\_id=25434&action\\_id=2](http://www.sptimes.ru/index.php?story_id=25434&action_id=2).

168. See Strategic Sectors Law, *supra* note 1, art. 8, ¶ 2. The required information includes: a statement of the proposed deal; a document showing that the investor is registered with the government; constituent documents if the applicant is a legal entity (that is, a corporate charter); the proposed deal; information on the business activities of the applicant; information on the members of the investor group or company; information on the person or entity controlling the applicant and the nature of that control; the proposed business plan of the strategic commercial organization; and information on the applicant’s share of the company at the time of the application. *Id.*

169. See *id.*

170. See PBN CO., FOREIGN INVESTMENT IN RUSSIAN STRATEGIC INDUSTRIES: DUMA APPROVES BILL 2 (2008), available at [http://www.pbnco.com/eng/files/PolicyMatters\\_April2008.pdf](http://www.pbnco.com/eng/files/PolicyMatters_April2008.pdf) (“The FSB and [the Federal Anti-Monopoly Service] FAS waged a battle for the role of lead government agency with jurisdiction over foreign investor applications seeking Russian government approval. While not stated explicitly in the legislation, the FAS emerged from the bureaucratic turf battle as the chief regulatory body on strategic sector issues.”).

171. Strategic Sectors Law, *supra* note 1, art. 13, ¶ 6. The Russian phrase used—“*operativno-rozysknye meropriyatiya*”—does not translate well. It is defined and regulated by the Law on Operational Search Measures, 144-FZ, July 12, 1995, available at <http://base.garant.ru/10104229.htm>. It is essentially spying in the context of law enforcement and, according to Article 6 of the law, may include interrogation, examination of documents, bugging of telephone conversations, and so forth.

cant will gain control of a strategic company as a result of the proposed deal; verifying the information in the application; determining whether allowing a deal would be a threat to Russia's national security; and, within fourteen days, sending the materials with a recommendation to the Commission.<sup>172</sup> Furthermore, if the Representative Body determines that the applicant will not gain control of the company, then it is obliged to return the application to the applicant within three days and inform the Commission.<sup>173</sup>

The Commission makes the final decision regarding a proposed deal on the basis of the Representative Body's recommendation.<sup>174</sup> The Commission can decline a deal if the applicant refuses to accept the obligations set forth in the legislation.<sup>175</sup> The entire application process takes three months, though in exceptional circumstances, it may be extended by three months through the Russian government's decision.<sup>176</sup>

The Strategic Sectors Law establishes consequences for non-compliance and the right of judicial review. Deals completed in violation of the law have no legal effect and investors who violate the law or who materially or repeatedly fail to comply with their obligations under the law lose their voting rights in shareholder meetings.<sup>177</sup> Finally, an investor can appeal in the courts either if the Representative Body fails to examine the application<sup>178</sup> or if the Commission issues a denial.<sup>179</sup>

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172. See Strategic Sectors Law, *supra* note 1, art. 9, ¶ 1. The definition of "threat to national security" is based upon the "totality of the circumstances" that create danger to "the individual, society, and (or) the state." *Id.* art. 3, ¶ 1. The characteristics upon which the threat assessment is based will be discussed in the next section.

173. See *id.* art. 9, ¶ 2.

174. See *id.* art. 11, ¶ 1.

175. See *id.* art. 12, ¶ 2.

176. *Id.* art. 11, ¶ 4.

177. See *id.* art. 15, ¶¶ 1-2.

178. *Id.* art. 10, ¶ 7.

179. *Id.* art. 11, ¶ 7. In this case, the investor must appeal to the Supreme *Arbitrazh* Court of the Russian Federation. See *id.* The Russian court system consists of three branches: the courts of general jurisdiction, which hear ordinary civil and criminal cases; the *arbitrazh* courts, which hear commercial disputes; and the Constitutional Court, which decides matters that interpret the Russian Constitution. See BURNHAM, MAGGS & DANILENKO, *supra* note 104, at 50. The Supreme *Arbitrazh* Court is essentially the court of final appeal for all commercial disputes in the country. See *id.* Interestingly, one researcher's findings "demonstrate[d] that the [*arbitrazh*] courts are both useable and are actually being used by firms," which is in contrast to the general pessimism about the Russian court system noted above. Kathryn Hendley, *Assessing the Rule of Law in Russia*, 14 CARDOZO J. INT'L & COMP. L. 347, 366 (2006).

## 6. How are Applications Judged?

The Strategic Sectors Law also defines the criteria for determining whether a deal threatens Russia's national security. Specifically, there are twelve possible characteristics of a commercial organization that are relevant to this question, mostly relating to work with military secrets, export-controlled products, and military contracts.<sup>180</sup> A law enforcement agency (for example, the FSB) investigates these various characteristics and provides its conclusions to the Representative Body.<sup>181</sup> If the organization has any of the listed features, then the deal may be allowed only in the absence of threats to national security and with the applicant's agreement to adhere to certain obligations.<sup>182</sup> Obligations that the Commission may impose on the foreign investor generally include ensuring the protection of secrets and implementing plans to ward off threats to Russia's national security.<sup>183</sup> Finally, any obligations that are placed on the investor should be included in the Commission's decision.<sup>184</sup>

## 7. The Duma Committee's Recommendations

In October 2007, the Committee on Industry, Construction, and Scientific Technology held a hearing on the Strategic Sectors Law after it passed its first reading.<sup>185</sup> The Committee's report

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180. See Strategic Sectors Law, *supra* note 1, art. 10, ¶ 1. The criteria include: work within the industries listed in Article 6; a license to work with state secrets; work with controlled technologies; work in the export of military products; work on government defense contracts in the past five years; registration as a natural monopoly; registration as having a "dominant position" in its market; right to exclusive intellectual property rights in areas of critical technology; the right to work on strategic subsoil deposits; the existence of an agreement with the government to exploit water resources; and a license to provide services in the television or radio spheres. *Id.*

181. *Id.* art. 10, ¶ 3.

182. See *id.* art. 12, ¶ 1.

183. See *id.* The obligations include: to form procedures to ensure protection and reporting of secrets; to continue delivering goods and services for defense contracts and to work in support of national military mobilization; to support compliance with tariffs; to follow the business plan included in the application; to immediately accept and plan concrete measures aimed at preventing the rise of national security threats of a military or emergency nature; to not decrease the number of middle-payroll workers during a period established in the approval of the deal; and to continue work on strategic subsoil deposits. *Id.*

184. *Id.* art. 12, ¶ 4.

185. Rekomendatsii Parlamentskikh Slushanij v Gosudartvennoi Dume na Temu "O Zakonodatel'nom Regulirovanii Uhastiya Inostrannykh Investirov v Strategicheskikh Otrasyakh Promyshlennosti Rossii," Komitet po Promyshlennosti, Stroitel'stvu I Naukoenmkim Tekhnologiyam, Oct. 15, 2007 [hereinafter Rekomendatsii Parlamentskikh Slushanij].

expressed concern over several aspects of the law, including the “very difficult” process for approving a deal and the vagueness of certain definitions.<sup>186</sup> The Committee concluded with several recommendations to both the State Duma and the government.<sup>187</sup> The most important recommendations it made to the Duma included adding natural resource deposits to the list of regulated industries, providing clearer definitions of “threat to national security” and “control” over an enterprise, and defining the instances where “operational-search” methods are used.<sup>188</sup> The recommendations the committee made to the government included: clarifying the position of the Commission, its members, and the method of examining the applications; listing the technologies that are critical for ensuring the national security of Russia; and more clearly defining the Representative Body.<sup>189</sup> Ultimately, some of the committee’s recommendations were incorporated into the final draft—such as including subsoil companies—while others were not—such as defining instances where operation-search methods may be used.

## 8. Major Differences Between the First and Second Drafts

The second—and final—draft of the Strategic Sectors Law introduced several major changes from the draft passed in the first reading. First, the number of sectors deemed strategic, and thus falling within the legislation, expanded.<sup>190</sup> The sectors that were added to the second draft of the law include major television stations,<sup>191</sup> major radio stations,<sup>192</sup> large printing<sup>193</sup> and publishing houses,<sup>194</sup> the fishing industry,<sup>195</sup> and the telecommunications industries.<sup>196</sup> Second, and perhaps most significantly, the second draft of the legislation added strategic subsoil resources to its list of covered industries.<sup>197</sup> Originally, a separate bill was planned to regulate strategic

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186. *Id.*

187. *See id.*

188. *Id.*

189. *See id.*

190. *See* Strategic Sectors Law, *supra* note 1, art. 6.

191. *Id.* art. 6, ¶ 34.

192. *Id.* art. 6, ¶ 35.

193. *Id.* art. 6, ¶ 41.

194. *Id.* art. 6, ¶ 42.

195. *Id.* art. 6, ¶ 40.

196. *Id.* art. 6, ¶ 37.

197. *Id.* art. 6, ¶ 39. The list of subsoil resources deemed strategic includes “deposits of uranium, diamonds, pure quartz, some rare-earth metals, nickel, cobalt, tantalum, niobium, beryllium, lithium, and platinum-group metals. Strategic natural resource deposits also include offshore deposits, as well as deposits with recoverable reserves of more than 70

subsoil resources, but it was ultimately incorporated into the Strategic Sectors Law.<sup>198</sup> Although the law does not apply to previous deals, the second draft requires foreign investors who own 5 percent or more of a strategic company's shares to notify the Representative Body within 180 days of the law's enactment.<sup>199</sup> Furthermore, the second draft requires investors to inform the Representative Body any time they acquire 5 percent or more of a strategic company's shares in the future, even if the acquisition does not result in the investor obtaining control of the company.<sup>200</sup> Additionally, certain natural monopolies—specifically, electricity, heating, and postal services—were exempted from some of the law's requirements in the second draft.<sup>201</sup> Lastly, the second draft tasked the Supreme *Arbitrazh* Court with hearing appeals from foreign investors whose applications the Commission denied.<sup>202</sup>

## 9. Initial Implementation of the Strategic Sectors Law

Since its passage, the Russian government has fully implemented the Strategic Sectors Law and begun examining applications from foreign investors.<sup>203</sup> On July 6, 2008, the government issued a decree establishing the administrative framework for the law's enforcement.<sup>204</sup> The decree explicitly named the FAS as the Representative Organ, something that was left undefined in the law.<sup>205</sup> The decree also established the Commission and detailed its functions.<sup>206</sup> Specifically, the decree gave the Commission the power to examine applications, to make decisions regarding the approval or denial of applications, and to set out a foreign investor's obligations under the law.<sup>207</sup> Also, the decree provided that the Commission's final decisions on an application will be decided by a simple

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million tons of oil, more than 50 billion cubic meters of natural gas, more than 50 tons of gold, and more than 500,000 tons of copper." PBN Co., *supra* note 170, at 3.

198. See Medetsky, *supra* note 143.

199. Strategic Sectors Law, *supra* note 1, art. 16, ¶ 3. Based on the date that Putin signed the bill into law, this deadline would be July 24, 2008.

200. *Id.* art. 14.

201. See *id.* art. 6, ¶ 36.

202. *Id.* art. 11, ¶ 7.

203. See Anatoly Medetsky, *Test Run for Strategic Sectors Law*, MOSCOW TIMES, Aug. 20, 2008, available at <http://www.themoscowtimes.ru/article/600/42/370010.htm>.

204. Postanovlenie Pravitel'tva Rossiiskoi Federatsii O Pravitel'svennoi Kommissii po Kontroliu za Osushchestvleniem Inostrannykh Investitsii v Rossiiskoi Federatsii, No. 510, July 6, 2008, available at <http://www.government.ru/content/governmentactivity/rfgovernmentdecisions/archive/2008/07/06/6811793.htm> [hereinafter Postanovlenie].

205. See *id.* ¶ 3.

206. See *id.*

207. *Id.* ¶ 4.

majority vote.<sup>208</sup> Finally, a government regulation from the same day established the membership of the Commission.<sup>209</sup> The Commission's most important members are Prime Minister Vladimir Putin (Chairman), First Deputy Prime Minister Igor Shuvalov (Deputy Chairman), and Head of the FAS, Igor Artemyev (Secretary).<sup>210</sup>

In the first year since its passage, the FAS has received tens of applications and hundreds of declarations pursuant to the law,<sup>211</sup> and the Commission currently has approximately twenty cases on its docket for its second session of 2009.<sup>212</sup> Though the process is not public, press reports of the more notable applications provide valuable insight into the Strategic Sectors Law's initial implementation.

In October 2008, the Commission approved the acquisition of Sukhoi Civil Aircraft by the Italian company Alenia Aeronautica.<sup>213</sup> All told, the Alenia purchased 254,621 shares for a total of \$183.1 million, and the deal was completed in April 2009 without any scandal or politics.<sup>214</sup> It should be noted, however, that the Alenia-Sukhoi deal was given ad hoc approval by then-President Putin in January 2008.<sup>215</sup>

In October 2008, the Commission also approved Archangel Diamond Corporation's (ADC) acquisition of a 49.9 percent stake in the Arkhangelskoye Geologodobychnoe Predpriyatie (AGP) from Lukoil.<sup>216</sup> ADC, a Canadian subsidiary of the De Beers Group, had

208. *See id.* ¶ 9.

209. Rasporiazhenie Pravitel'stva Rossiiskoi Federatsii Sostav Pravitel'svennoi Komissii po Kontroliu za Osushchestvleniem Inostrannykh Investitsii v Rossiiskoi Federatsii, Ros. gaz., July 6, 2008, available at <http://www.rg.ru/2008/07/11/komissiya-dok.html> [hereinafter Rasporiazhenie].

210. *Id.* The other fourteen members consist of the heads of various government ministries and agencies. *See id.*

211. From May to December 2008, the FAS processed 234 filings pursuant to the Strategic Sectors Law. Two Hundred twenty-four of those were made under the "notification" requirement of Article 16, Section 3, while ten were made under the "acquisition" provision of Article 14. *See* Press Release, Bashkortostanskoe UFAS Rossii, Ob Informirovani Inostrannykh Investorov o Neobkhodimosti Podachi Uvedomlenij (Mar. 12, 2009), available at <http://bash.fas.gov.ru/news.php?id=97>.

212. *Pravitel'stvennaya Komissiya Rassmotrit Zayavleniya o Pokupke Aktivov v RF*, VZGLYAD, Apr. 21, 2009, <http://www.vz.ru/news/2009/4/21/278842.html>.

213. Anastasiya Savinykh, *Investorov Puskayut Parami*, IZVESTIYA, Oct. 13, 2008, <http://www.izvestia.ru/economic/article3121497/index.html>.

214. Gleb Stolyarov & Aleksei Nikol'skij, *Alenia Preletela*, VEDOMOSTI, Apr. 8, 2009, <http://www.vedomosti.ru/newspaper/article.shtml?2009/04/08/190076>.

215. *Russia's Putin Approves Alenia Buy of 25 pct Stake in Sukhoi*, AFX NEWS LTD., Jan. 14, 2009, available at <http://www.forbes.com/feeds/afx/2008/01/14/afx4526790.html>.

216. Savinykh, *supra* note 213.

been involved in a bitter decade-long dispute with Lukoil over AGP, which owns exclusive rights to the Grib pipe, at the Verkhovina prospect diamond mine in Arkhangelsk, Russia.<sup>217</sup> The companies came to an informal agreement on the dispute in April 2008, right before the Strategic Sectors Law came into effect, in a meeting mediated by then-President Putin, though the subsequent contractual arrangement fell within the law's purview.<sup>218</sup> After the Commission approved the deal at its October meeting, however, it issued a formal approval with a condition "that diamonds extracted . . . are processed in Russia in volumes to be agreed with the Russian Government."<sup>219</sup> The parties never agreed to the exact contours of this condition, and in December 2008, ADC issued a Notification of Termination Event, which stated that ADC would exercise its option to terminate the Share Purchase Agreement (SPA) if the issues with the Russian government were not settled by December 31, 2008.<sup>220</sup> The issues were not resolved and ADC formally terminated the SPA in January 2009.<sup>221</sup> Finally, in May 2009, De Beers reportedly voted to sell its stake in ADC to "a lawyer-managed US fund, which is well-known as an investor in high-value litigations, with a strong record of winning large settlements for the cases it has taken on."<sup>222</sup>

In February 2009, the Commission held its second session, with two of the approved applications receiving press coverage.<sup>223</sup> First, Barrick Gold acquired an additional 29 percent stake in Fyodorova

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217. John Helmer, *Russian Raiders Bury Hatchet with De Beers over Archangel Diamond – But Who Will Wield the Shovel?*, MINEWEB, Apr. 16, 2008, <http://www.mineweb.com/mineweb/view/mineweb/en/page37?oid=51181&sn=detail>. ADC's dispute resolution strategy included negotiations with Lukoil, arbitration in Stockholm, and suing Lukoil in a Colorado court. *See id.* Essentially, ADC accused Lukoil owner Vagit Alekperov of depriving ADC of its rights to AGP through various contract violations. *See id.*

218. *See id.*

219. Press Release, Archangel Diamond Corporation, Archangel Diamond Corporation Receives Formal Decision of Russian Government Conditional Consent for its Acquisition of a 49.99% Interest in AGD (Oct. 29, 2008), *available at* [http://www.archangeldiamond.com/pdf/ADC\\_News-Release-Oct-29-08.pdf](http://www.archangeldiamond.com/pdf/ADC_News-Release-Oct-29-08.pdf).

220. *See* Press Release, Archangel Diamond Corporation, Archangel Diamond Corporation Delivers Notification of a Termination Event (Dec. 8, 2008), *available at* [http://www.archangeldiamond.com/pdf/ADC\\_News-Release-Dec-8-08.pdf](http://www.archangeldiamond.com/pdf/ADC_News-Release-Dec-8-08.pdf).

221. Press Release, Archangel Diamond Corporation, Archangel Diamond Corporation Terminates Transaction for Purchase of Shares in AGD (Jan. 12, 2009), *available at* [http://www.archangeldiamond.com/pdf/ADC\\_News-Release-Jan-12-09.pdf](http://www.archangeldiamond.com/pdf/ADC_News-Release-Jan-12-09.pdf).

222. John Helmer, *Dances with Bears: De Beers Sells Archangel Diamond to Litigation Attack Fund*, June 1, 2009, <http://johnhelmer.net/?p=1173>.

223. Andrei Biryukov & Maksim Tovkailo, *Vladimir Putin Gifts Foreigners with Gold, Platinum, and Palladium*, GZT.RU, Feb. 4, 2009, <http://www.gzt.ru/business/2009/02/04/223032.html>.

Tundra, bringing its total to 79 percent.<sup>224</sup> Second, Universal Cargo Logistics Holding BV (UCLH) purchased the Taganrog Shipyard from Valars Group.<sup>225</sup> The purchasers, though Russian, were forced to comply with the Strategic Sectors Law because they made the purchase through offshore entities.<sup>226</sup>

## 10. Commentary on the Strategic Sectors Law

The Strategic Sectors Law has elicited more commentary than usual for Russian legislation. Some observers criticized the law for being restrictive and for involving the secret services in business. For example, one Russian commentator noted that “the former Chekists will have a full carte blanche to interfere in the economic sphere.”<sup>227</sup> Others claimed that the strengthened strategic policies contained in the law will lead to a decline in foreign investment.<sup>228</sup> Still others criticized the inclusion of certain sectors, such as fishing and newspapers.<sup>229</sup>

Many investors, however, consider the law to be a welcome development. Some, including representatives of the Association of European Businesses in Russia, even participated in the drafting of the legislation, and some of their suggestions were incorporated into the legislation.<sup>230</sup> Andrew Somers, President of the American Chamber of Commerce in Moscow, also supported the legislation, saying: “The most interesting thing about the law is that there now

224. *Id.*

225. Elena Leont'eva, *Prodavets Smenilsya*, GUDOK, Feb. 9, 2009, <http://gudok.ru/index.php/68006>.

226. See Biryukov & Tovkailo, *supra* note 223.

227. Ivan Petrov, *Lublyanka Zaglanet v Portfel' Investoru*, RUSSKII KUR'ER, July 23, 2007, <http://www.ruscourier.ru/archive.php?id=2892>. The term “Chekist” refers to members of the Emergency Commission (Chrezvychainaya Kommisiya), which was the first state security organization, later renamed the Committee for State Security (KGB), and now the FSB. *Id.*

228. See, e.g., Kari Liuhto, *A Future Role of Foreign Firms in Russia's Strategic Industries* 31 (Electronic Publications of the Pan-European Institute, Working Paper No. 4/2007), available at [http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Liuhto04\\_07.pdf](http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Liuhto04_07.pdf).

229. See, e.g., Anatoly Medetsky & Tai Adelaja, *Publishing, Internet and Fish Called Strategic*, MOSCOW TIMES, Mar. 6, 2008, available at <http://www.themoscowtimes.com/stories/2008/03/06/003.html>.

230. C. Anne Shupe, *AEB Weighs in On Draft Investment Bill in Duma*, MOSCOW NEWS, Feb. 2, 2008, <http://mnweekly.rian.ru/business/20080228/55312947.html> (“The AEB Legal Committee, represented at the conference by Deputy Chairman Alex Stoljarskij, has expressed support for ‘the introduction of a law setting clear guidelines for foreign investors’ and mentioned that their Russian colleagues seriously considered their amendment suggestions.”).

will be a law defining the rules of the game.”<sup>231</sup> Other analysts argued that the legislation likely will not have a net negative impact on FDI because there are already limits on foreign access to strategic companies.<sup>232</sup> Indeed, many claim that the “new laws will not just set clear rules for foreign investors, they will also set rules for Russian bureaucrats, and the clarification of these rules will likely encourage FDI into Russia.”<sup>233</sup> Thus, the reaction to the Strategic Sectors Law has been mixed, though investor groups have generally expressed optimism about the law and its likely effects.

## 11. How to Evaluate the Strategic Sectors Law—the OECD Criteria

As stated above, a central premise of this Note is that Russia needs FDI to sustain its strong economic growth and to diversify its economy. Thus, one key consideration is whether the Strategic Sectors Law unnecessarily or excessively limits the growth of foreign investment. An additional, complementary approach is to judge the law from a legal perspective by determining if the law is, for example, well-written. This Note will adopt criteria proposed by the OECD in recent policy statements regarding Russia and strategic policies. The OECD, established in 1961, is an organization of “30 member countries committed to democratic government and the market economy” and is a strong proponent of FDI.<sup>234</sup> The main justification for using OECD criteria is that Russia wants to join the organization and therefore is mindful of its recommendations.<sup>235</sup> Indeed, when the OECD officially invited Russia to join in May 2007, the head of economic cooperation at the Russian Ministry of Foreign Affairs said, “[i]t’s something we’ve been waiting for for 11 years.”<sup>236</sup>

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231. Jason Bush, *Russia to Set Investment Rules*, BUS. WK., Mar. 19, 2008, available at [http://www.businessweek.com/print/globalbiz/content/mar2008/gb20080319\\_484201.htm](http://www.businessweek.com/print/globalbiz/content/mar2008/gb20080319_484201.htm).

232. *Russian Parliament Adopts Foreign Investment Law*, THOMSON FIN. NEWS, Mar. 21, 2008, available at <http://www.forbes.com/markets/feeds/afx/2008/03/21/afx4802244.html>. The limits referred to most likely include formal (that is, codified) and informal rules.

233. Jules Evans, *Kremlin to Clarify Rules of Game for FDI*, 1 RUSS. & EURASIA ECON. DIG. 17, 17 (2007).

234. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], OECD ANNUAL REPORT 2007, at 7 (2007).

235. *Russia Could Join OECD 3 Years After WTO Accession – Ministry*, RIA NOVOSTI, Nov. 29, 2006, <http://en.rian.ru/russia/20061129/56191465.html>.

236. Rory Watson, *OECD Invites Russia in as Expansion Gets Under Way*, TIMES (London), May 17, 2007, available at <http://business.timesonline.co.uk/tol/business/economics/article1800929.ece>.

In 2006, the OECD held a roundtable on investment freedom and strategic policies. The group noted the recent trend in many countries—including the United States, France, Germany, and Russia—to strengthen strategic policies.<sup>237</sup> The roundtable concluded that countries should be guided by three concerns with regard to investors: (1) a strategic industries policy “should be as transparent as possible, taking into account the need to protect classified information and sensitive business information”; (2) the process “should be predictable in the sense that investors know beforehand the procedures”; and, (3) that “regulation should be non-discriminatory.”<sup>238</sup> Finally, the group offered several recommendations to countries implementing strategic policies. The most important of the roundtable’s recommendations were that the lists of strategic industries should be defined “as narrowly as possible,” that “[n]ational security should not be used as a pretext for protectionism,” and that the “executive branch is better placed to balance the pros and cons of an investment project than the legislative branch.”<sup>239</sup> The OECD further commented upon the upcoming Russian legislation in 2006 in its economic policy review of Russia. Specifically, the authors concluded the following:

It is important that . . . the law under discussion defines the sectors in question, limits the scope of restrictions to foreign investor participation based on national security grounds, and clarifies the modalities of government review and permission procedures, in particular by setting clearly the time limits for notifications of government decisions.<sup>240</sup>

In sum, this Note will analyze Russia’s Strategic Sectors Law based on these principles and recommendations—specifically, transparency of the process and requirements, narrowly tailored and defined areas of regulation, non-discrimination, executive branch control of the process, and the protection of business secrets.

### III. ANALYSIS

#### A. *The Transparency of the Process and Requirements*

On its face, the Strategic Sectors Law’s procedures appear to be relatively transparent and predictable. First, the law is clear on

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237. See OECD, ROUNDTABLE, *supra* note 3, at 1.

238. *Id.* at 5.

239. *Id.*

240. OECD, RUSSIAN INVESTMENT POLICY, *supra* note 40, at 57.

which enterprises trigger the application of the law.<sup>241</sup> Also, it defines which characteristics of a business within those industries will raise national security concerns.<sup>242</sup> Thus, the law provides a foreign investor with a descriptive guide that will allow the investor to evaluate whether an acquisition would require prior approval.

Although the criteria that govern the acquisition of strategic enterprises are transparent, foreign investors most likely will be disconcerted over the procedures for obtaining approval. It is unclear what constitutes a threat to national security, much less what “gives rise” to threats to national security.<sup>243</sup> In some circles of the Russian government, foreign ownership itself is a threat to national security.<sup>244</sup> Since the very groups that lobbied for an even stricter law now will be entrusted with determining whether a national security threat exists, this result is even more likely.<sup>245</sup> Security itself being a subjective concept, it would not be difficult for the Representative Body or the Commission to disguise protectionism as ensuring the national security of Russia.<sup>246</sup> Thus, the law could be improved if it included criteria for why a deal *should* be approved, such as an overwhelming need for investment in a particular sector. Such additional, positive criteria would allow for a balancing of the interests of both national and economic security. Finally, investors might be wary of voluntarily subjecting themselves to the scrutiny of the FSB, which is partially in charge of investigating national security threats in the legislation.<sup>247</sup> Investors might justifiably worry that the FSB will either serve the interests of a domestic patron or seek compensation for a favorable security assessment.<sup>248</sup> An improved law would explicitly define the scope, circumstances, and methods used to conduct operational-search measures, as the committee report recommended.<sup>249</sup>

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241. See Strategic Sectors Law, *supra* note 1, art. 6.

242. See *id.* art. 10, ¶ 1.

243. See *id.* The Duma Committee recommended that all the key terms in the legislation be clarified. See Rekomendatsii Parlamentskikh Slushanij, *supra* note 185.

244. See Gosling, *supra* note 79. These “circles” mostly consist of the *siloviki* who lobbied to increase the number of industries in the control list and especially insisted on the inclusion of natural monopolies. See *id.*

245. See *id.*

246. See OECD, ROUNDTABLE, *supra* note 3, at 5 (observing that “[n]ational security should not be used as a pretext for protectionism”).

247. See Strategic Sectors Law, *supra* note 1, art. 10, ¶ 3.

248. See Sweeney & Zhdannikov, *supra* note 120. The TNK-BP example especially suggests how the security services can be a tool of a domestic, and specifically state-owned, competitor. See *id.*

249. See Rekomendatsii Parlamentskikh Slushanij, *supra* note 185.

Finally, the obligations that may be imposed on investors are vague, and when they may be imposed is left open to question.<sup>250</sup> For example, the law provides for the obligation to take measures to prevent threats to Russia's national security.<sup>251</sup> Not only is this vague, but also it risks allowing the state to dispossess investors whenever they lack adequate plans to counter threats. Another potentially troubling obligation for foreign investors is the requirement to maintain the number of mid-level salaried employees for a given period.<sup>252</sup> The right to choose how many employees to hire is fundamental to ownership, and this obligation risks being imposed based on political concerns over layoffs at formerly-Russian businesses.

### B. *The Restrictions are Narrower than Critics Claim*

A major strength of the law is that it clearly limits its application to enterprises of certain industries, rather than retaining the option of an ever-expanding interpretation of which industries are strategic.<sup>253</sup> The size of the list is even deceptive—the regulated businesses can be categorized into fifteen groups.<sup>254</sup> Furthermore, most of the industries included in the list are arguably related to Russia's national security.<sup>255</sup> Nevertheless, the inclusion of certain industries—fishing, printing and publishing houses, and telecommunications companies—is puzzling.<sup>256</sup>

It is also troubling that natural monopolies were included in the list of regulated industries.<sup>257</sup> Effectively, any attempt by a foreign investor to acquire, for example, an oil pipeline company, will need to go through the entire evaluation process. The problem is that these industries have less to do with national security than some of the other industries on the control list, in that they do not deal with weapons, defense, or state secrets.<sup>258</sup> Furthermore, these

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250. See Strategic Sectors Law, *supra* note 1, art. 12, ¶ 1.

251. See *id.*

252. *Id.*

253. See *id.* art. 6. The vast majority of the categories—the nuclear industry, armaments and ammunition, the cryptological industry, and so forth—possess a clear connection to national security.

254. See *supra* note 156 and accompanying text.

255. See *id.*

256. *Id.* With regards to fishing, however, Russia did recently call for a five-year ban on sturgeon fishing in the Caspian Sea. See Adrian Blomfield, *Russia Bans Sturgeon Fishing in Caspian Sea*, TELEGRAPH (U.K.), Mar. 2, 2008.

257. See Strategic Sectors Law, *supra* note 1, art. 6, ¶ 36.

258. See *id.* art. 6.

industries are arguably the most in need of investment in Russia.<sup>259</sup> This was recognized and is apparent in the changes to the law between the first and second drafts. In the final draft, the law's coverage exempted certain natural monopolies that are in great need of investment—electricity and heating.<sup>260</sup> Still, it is not clear how limiting much-needed investment in other areas of Russia's infrastructure will serve the national security interests of the nation. Indeed, by blocking these industries' access to capital for modernization, Russian authorities could be endangering those the legislation intends to protect. Certain groups of investors may forego pursuing an investment entirely if it requires prior approval from the Russian government.

### C. *The Law is Facially Non-Discriminatory*

Laws that restrict foreign investment are inherently discriminatory. The Strategic Sectors Law does not *prohibit* private foreign investment in any industry—it merely subjects it to prior approval in certain circumstances.<sup>261</sup> Nonetheless, the law may in some cases have a prohibitive impact on certain risk-averse investors. On the other hand, the law may actually reduce risks and attract more investors because it establishes clear rules and a predictable approval mechanism. What is more important is whether this discrimination is for a legitimate purpose and whether foreign investors from one country will be treated differently than other foreign investors.<sup>262</sup> The Siemens example described above certainly does not inspire confidence.<sup>263</sup> Indeed, if the FAS refused a deal at least partially on the basis of a Russian competitor's interest in the target company, then similar outcomes might be expected from the Commission.<sup>264</sup> The Russian government could, however, add a provision in the legislation prohibiting discrimination on the basis of an applicant's home country. An investor's appeal of a decision to the Supreme *Arbitrazh* Court could be an effective check on the Commission's power.<sup>265</sup> This especially will be the case if the Supreme

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259. See *supra* notes 131-40 and accompanying text.

260. See Strategic Sectors Law, *supra* note 1, art. 6, ¶ 36.

261. Government investors, in contrast, are prohibited from acquiring control over strategic enterprises. See Strategic Sectors Law, *supra* note 1, art. 2, ¶ 2.

262. See OECD, ROUNDTABLE, *supra* note 3, at 5.

263. See *supra* notes 131-40 and accompanying text.

264. See generally Press-Sluzhba FAS Rossii, *supra* note 137.

265. See Strategic Sectors Law, *supra* note 1, art. 11, ¶ 7.

*Arbitrazh* Court continues on its recent trend of increasing competence and independence.<sup>266</sup>

#### D. *Legislative Branch Participation Should Be Minimized*

Although the law does not provide for formal participation at any stage of the application review process, the Siemens case demonstrates that the Russian Duma can have informal, political influence over a purportedly neutral review process.<sup>267</sup> The Representative Body and Commission could minimize this problem if their activities were conducted privately until their final decision. Foreign investors likely would appreciate not having their business plans in Russia publicly broadcast.

#### E. *Business Secrets Might be Leaked*

Another troublesome aspect of the Strategic Sectors Law is the possibility for industrial espionage on applicant investors.<sup>268</sup> The law permits “operational search measures” without defining their scope and duration.<sup>269</sup> Thus, investors might worry that applying to acquire a strategic enterprise will open up their entire company to the Russian secret services.<sup>270</sup> To some extent, foreign investors likely assume this activity occurs on a regular basis in Russia, regardless of what sector is involved.<sup>271</sup> Nonetheless, the level of scrutiny permitted by the law might prove prohibitive for certain foreign investors. Most importantly, companies do not want their proprietary information available on the black market for their competitors to buy. Therefore, the law would be better if it limited the information within the scope of operational search measures and provided special administrative or judicial recourse to companies whose secrets have been leaked.<sup>272</sup>

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266. See Hendley, *supra* note 179, at 366.

267. See Yamabaeva, Grib & Kornysheva, *supra* note 132.

268. See OECD, *ROUNDTABLE*, *supra* note 3, at 5 (“Companies will not apply for approval if they perceive a risk that confidential information will be made available to competitors or the general public.”).

269. Strategic Sectors Law, *supra* note 1, art. 13, ¶ 6.

270. See Petrov, *supra* note 227 (explaining that the law authorizes the FSB to investigate companies).

271. See Myers, *supra* note 125. Despite problems that companies like Motorola have experienced, foreign investment continues to rise, which demonstrates a certain level of comfort with the uncertainty of doing business in Russia. See *id.* The willingness to shoulder such risks is likely due to the high return on investments in Russia.

272. See Strategic Sectors Law, *supra* note 1, art. 13, ¶ 5 (stating only that damage inflicted on investors “shall be recovered according to procedures stipulated by Russian Federation legislation.”).

F. *The Strategic Sectors Law Establishes Clear 'Rules of the Game'*

Despite these few concerns, foreign investor groups likely support the Strategic Sectors Law because it goes a long way in establishing clear rules of the game for foreign investors.<sup>273</sup> Investors generally will know beforehand whether a company is considered strategic and the criteria used to determine whether a proposed acquisition must be approved by the Commission.<sup>274</sup> The law also creates clear time limits on the application review and decision process, thereby preventing the government from drawing out the approval process until the investor gives up or pays up.<sup>275</sup> These features will provide investors with the kind of notice that is necessary to make rational investment decisions. Most importantly, the law only regulates foreign investor acquisitions that will result in the control of strategic companies.<sup>276</sup> Thus, investors are still free to acquire non-controlling stakes of companies in any of the industries listed in the legislation without an application. Finally, the law's overall impact is likely to be small. The very nature of the regulated industries would make most investors hesitate before attempting to acquire a native company.<sup>277</sup> If anything, the law will reduce uncertainty over these decisions and thereby increase total investment.

G. *Implementation of the Law—Nightmare or Silver Bullet?*

The initial implementation of the law demonstrates that it is neither the death knell nor panacea for foreign investment that both sides were predicting. Indeed, several applications were approved before the one-year anniversary of the law, and hundreds of filings have been processed without incident.<sup>278</sup> Even in sensitive industries like aircraft producers and ports, acquisitions went through without any political meddling.

At the same time, the case of ADC reveals some truths about Russia's investment climate that raise questions about the Strategic Sectors Law's effectiveness. First, even the combination of the ad

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273. Articles 6, 9, 10, and 11 especially do a good job of detailing what is regulated, how a proposed acquisition is evaluated, and who evaluates the acquisition and makes the decision. *Id.* arts. 6, 9, 10-11.

274. *See id.* arts. 6, 10.

275. *See id.* art. 11, ¶ 4.

276. *Id.* art. 2.

277. *Id.* art. 6. The majority of the regulated companies are in the military sector which, as the Siemens example demonstrates, is already a challenging area for foreign investors.

278. *See* Press Release, *supra* note 211.

hoc approval of then-President Putin and formal approval of now-Prime Minister Putin as head of the Commission was insufficient to enable ADC to assert follow through on a SPA. This suggests that Russia's poor investment climate stems not simply from high-level politics and state intervention, but also from poor business practices by local partners and purely local administrative interference. In other words, even though the president and prime minister may officially support more foreign investment, this often has little influence over the reality that companies face. The problems that ADC faces show that Russia's investment environment is plagued by deeper, cultural issues regarding a lack of respect for property rights and interference with business relations. Therefore, the Strategic Sectors Law is only one small piece of a broader effort that Russia must make to transform its business environment, and bring it up to international norms.

#### IV. CONCLUSION

The new strategic sectors law arose out of an uncertain and, at times, arbitrary regulatory environment for foreign investment in Russia. The law clarifies in what industries and in which situations foreign majority ownership should be limited. It also establishes clear procedures for investors to apply for an acquisition, and provides legal recourse when a deal is refused for reasons not covered by the law. Legitimate concerns do exist regarding the protection of company secrets, the perhaps overly broad application of the law to certain industries, and the possibility for a discriminatory application of the law. Ultimately, however, the new law is a step forward from the previous absence of a legal framework for strategic industries. While the proposed law does indeed limit foreign investment, its likely effect will be minimal and the establishment of clear and predictable rules in place of murky and informal mechanisms will encourage the growth of FDI.

