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JOINT VENTURE LAW IN THE SOVIET UNION

I. INTRODUCTION

The era of *glasnost*¹ and *perestroika*² has brought broad and sweeping changes to the Soviet Union.³ Major revisions in the Soviet law concerning joint ventures with Western firms⁴ promise to benefit the Soviets, as well as Western businesses eager to acquire access to the Soviet domestic market.⁵

While enthusiasm for joint ventures is high, Western businessmen should note the current hazards of doing business in the Soviet Union.⁶ These hazards arise, in part, from differences between Soviet and Western

1. *Glasnost*, or openness, is the term chosen by President Mikhail Gorbachev to signify his policy of allowing greater political freedoms, particularly in regard to speech and information. Rogers, *Glasnost & Perestroika: An Evaluation of the Gorbachev Revolution and Its Opportunities for the West*, 16 DEN. J. INT'L L. & POL'Y 209, 209-10 (1988); see also Nelan, *The Year of the People: A Catalyst for Reform from Moscow to Bucharest, Gorbachev Has Transformed the World*, TIME, Jan. 1, 1990, at 46.

2. *Perestroika*, or restructuring, is the term used to describe Gorbachev's measures to reform the Soviet state's stagnant centrally planned economy. See Rogers, *supra* note 1, at 209-10; see also Nelan, *supra* note 1, at 46.

3. Rogers, *supra* note 1, at 209-10. See generally Breslauer, *Linking Gorbachev's Domestic and Foreign Policies*, 42 J. INT'L AFF. 267 (1989); Ericson, *Soviet Economic Reforms: The Motivation and Content of Perestroika*, 42 J. INT'L AFF. 317 (1989); Lewin, *Perestroika: A New Historic Stage*, 42 J. INT'L AFF. 299 (1989).

4. The USSR officially allowed the creation of joint ventures between Soviet and Western partners in January 1987. Burt, *Joint Venture Experience: Observations on the Business and Legal Challenges*, 22 N.Y.U. J. INT'L L. & POL. 435 (1990). At this time, two separate decrees were passed: a general authorization from the Presidium of the Supreme Soviet of the USSR entitled *Questions Concerning the Establishment in the Territory of the USSR and the Operation of Joint Ventures, International Amalgamations and Organizations with the Participation of Soviet and Foreign Organizations, Firms and Management Bodies*, 2 VED. VERKH. SOV. SSSR, item 35 (1987), translated in UNITED NATIONS, JOINT VENTURES AS A FORM OF INTERNATIONAL ECONOMIC COOPERATION 144-45 (1989) [hereinafter JOINT VENTURES]; and a decree from the USSR Council of Ministers entitled *The Establishment and Operation of Joint Ventures in the Territory of the USSR with the Participation of Soviet Organizations and Firms from Capitalist and Developing Countries*, 9 SP SSSR, item 40 (1987), translated in JOINT VENTURES, *supra*, at 145-52.

5. INT'L CHAMBER OF COMMERCE & USSR CHAMBER OF COMMERCE & INDUSTRY, GUIDE TO JOINT VENTURES IN THE USSR 3 (1988) [hereinafter JOINT VENTURE GUIDE].

6. Osakwe, *The Death of Ideology in Soviet Foreign Investment Policy: A Clinical Examination of the Soviet Joint Venture Law of 1987*, 22 VAND. J. TRANSNAT'L L. 1, 9 (1989).

legal systems,⁷ and the new legislation's conflicts with existing Soviet laws.⁸ An additional and perhaps most problematic concern is the continuous deterioration of the Soviet economy.⁹ More time is needed to test the viability of joint ventures and to assess the future stability of the Soviet marketplace.

II. JOINT VENTURE LAW IN THE USSR

The introduction of communism to Russia, which was brought about by the Revolution of 1917, effectively ended all previous foreign investment allowed under the czarist regime.¹⁰ Western business interests within the Soviet Union were restored partially in March 1921 when Lenin¹¹ sought to revitalize the Soviet economy with his New Economic Policy (NEP).¹² This policy was broadened by the enactment of the 1923 Law on Concessions,¹³ which allowed more foreign participation in Soviet business.¹⁴ This open market policy, however, was short lived. In 1930, Stalin¹⁵ outlawed joint ventures with all foreign firms,¹⁶ stating that outside control over any part of the Soviet Union was

7. JOINT VENTURE GUIDE, *supra* note 5, at 5.

8. See Osakwe, *supra* note 6, at 12.

9. See Watson, *Why He Is Failing*, NEWSWEEK, June 4, 1990, at 18. President Gorbachev's reforms are increasingly seen as ineffective and perhaps unworkable. *Id.* This view is shared by both the Soviet populace and foreign experts. *Id.* These perceptions have created a climate of instability which may lead to Gorbachev's downfall. *Id.* Nevertheless, it is still unclear if these naysayers will prove to be correct. *Id.* at 19.

10. See generally B. DMYTRYSHYN, USSR: A CONCISE HISTORY 64-149 (4th ed. 1984).

11. Vladimir Lenin was the father of Soviet communism and the supreme Soviet ruler until his death in 1924. See Friedrich, *Headed for the Dustheap*, TIME, Feb. 19, 1990, at 36-37. For a further discussion of Lenin, see R. PAYNE, THE LIFE AND DEATH OF LENIN (1964).

12. Comment, *Joint Venture Law in the Soviet Union: The 1920s and the 1980s*, 9 NW. J. INT'L L. & BUS. 634 (1989). For a discussion of NEP, see B. DMYTRYSHYN, *supra* note 10, at 119-24.

13. Comment, *supra* note 12, at 635.

14. *Id.* See generally J. QUIGLEY, THE SOVIET FOREIGN TRADE MONOPOLY 35, 47-48 (1974); G. SMITH, SOVIET FOREIGN TRADE 60-63 (1973).

15. From the power struggle resulting upon Lenin's death, Joseph Stalin emerged as the leader of the USSR. Friedrich, *supra* note 11, at 37-38. For a discussion of the power struggle following Lenin's death, see B. DMYTRYSHYN, *supra* note 10, at 139-45. Stalin held this position until his death in 1953. Friedrich, *supra* note 11, at 37.

16. Comment, *Joint Ventures in the Soviet Union: A Legal and Economic Perspective*, 16 HARV. INT'L L.J. 390, 390 (1975).

ideologically improper.¹⁷ Foreign direct investment thereafter consisted only of Industrial Cooperation Agreements ("ICAs").¹⁸

The Soviets approved joint ventures with other socialist countries by 1983,¹⁹ but did not officially discuss partnerships involving Western investors until 1986.²⁰ This led to the Soviets' January 1987 decree permitting and outlining procedures for joint ventures with capitalist and developing countries.²¹ Subsequent amendments in September 1987²² and December 1988²³ further clarified the regulations.

17. G. SMITH, *supra* note 14, at 60.

18. Recent Developments, *Foreign Investment: New Soviet Joint Venture Law*, 28 HARV. INT'L L.J. 473, (1987).

Generally, ICAs . . . take one of four forms: 1) *coproduction and specialization*: both partners produce components for a final product to be assembled by one partner; technology is usually supplied by one partner, and there is usually an agreement to market the product in each partner's respective market; 2) *subcontracting*: the socialist partner manufactures the product according to the Western partner's specifications, and delivers the products to the Western partner; 3) *licensing*: the Western firm licenses technology to the socialist partner and payment is made not in the ordinary form of hard currency royalties, but in products or components resulting from the use of the license; 4) *turnkey plants*: the Western partner sells plant, equipment, and technology to a socialist partner and is paid in the products of the newly created plant.

Comment, *supra* note 16, at 391-92; see Berman, *Joint Ventures Between United States Firms and Soviet Economic Organization*, 1 INT'L TRADE L.J. 139, 145 (1975-76).

19. Note, *Prospects for Western Investment: A Comparison of Joint Venture Laws in the Soviet Union, Yugoslavia and China*, 12 B.C. INT'L & COMP. L.R. 103, 108 & n.45 (1989) (citing The Edict on the Procedures for Effectuating Activity on the Territory of the USSR of Joint Economic Organizations of the USSR and Other COMECON Countries, VED. VERKH. SOV. SSSR, no. 22, item 330 (1983)). CMEA or COMECON was formed by the socialist nations to promote economic trade between member nations. *Id.* Its members include the USSR and the Eastern European nations of Poland, Czechoslovakia, Hungary and Bulgaria. Recent Developments, *supra* note 18, at 474 n.9. Due to the recent democratization of Eastern Europe, the alliance has become increasingly irrelevant. *Id.* Currently, the majority of the CMEA nations are more interested in economic relations with Western countries than in relations with one another. *Id.* On June 28, 1991, the nine member nations of COMECON formally agreed to disband the organization. Greenhouse, *Soviet Trade Bloc Is Out of Business*, N.Y. Times, June 29, 1991, at A3, col. 1.

20. Note, *supra* note 19, at 108-09.

21. JOINT VENTURES, *supra* note 4, at 145-52.

22. In September 1987, the USSR Council of Ministers issued an amendment to the January 1987 decree entitled *Additional Measures to Improve the Country's External Economic Management in the New Conditions of Economic Management*, 49 SP SSSR, no. 9, item 40 (1987), translated in JOINT VENTURES, *supra* note 4, at 179-83.

23. In December 1988, the USSR Council of Ministers issued an additional decree amending the January 1987 law, this decree was entitled *Further Development of the*

A. *The Soviet Shift Towards Joint Ventures*

Inspiring *perestroika* is the Soviet government's persistent belief that the traditional centrally planned economy has not provided a level of development on par with industrialized capitalist countries.²⁴ The scarcity of consumer goods and modern technology is concrete proof that the Soviet Union has fallen behind developed Western nations. Gorbachev²⁵ sees joint ventures as a "major instrument" for implementing economic reform.²⁶

In addressing these economic shortfalls, the January 1987 decree specifically stipulates that the USSR ministries and agencies pursue the following objectives:

- to satisfy more fully national requirements in certain types of industrial products, raw materials, and foodstuffs;
- to attract to the Soviet national economy the best in foreign processes, technologies and management, as well as additional material and financial resources;
- to further develop the country's export capability; [and]
- to reduce unnecessary imports."²⁷

For Western businesses, the Soviet Union represents a store of abundant natural resources²⁸ and, like the People's Republic of China in 1979, a tempting, untapped consumer market.²⁹ With a Soviet partner, a Western business is better able to assess the needs of the Soviet market

Foreign Economic Activity of State, Cooperative and Other Public Enterprises, Associations and Organizations, 2 SP SSSR, item 7 (1988), translated in Theroux & George, *Joint Ventures in the Soviet Union: Law and Practice*, in A NEW LOOK AT DOING BUSINESS WITH THE SOVIET UNION 1989, at 221, 289-303 (E. Theroux ed. 1989) [hereinafter A NEW LOOK].

24. Ericson, *supra* note 3; see Bialer, *Domestic and International Factors in the Formation of Gorbachev's Reforms*, 42 J. INT'L AFF. 283, 286 (1989).

25. Mikhail Gorbachev is currently President of the USSR and General Secretary of the Communist Party. See Friedrich, *supra* note 11, at 37. He ascended to power in 1985 and subsequently instituted a policy of massive political and economic reforms. *Id.*

26. Osakwe, *supra* note 6, at 4.

27. JOINT VENTURE GUIDE, *supra* note 5, at 19. A related motivation is the Soviet Union's declining birthrate, particularly in the Russian Republic. Note, *supra* note 19, at 104. This decline is likely to cause a labor shortage in the coming years. *Id.*

28. Note, *supra* note 19, at 103. These resources include natural gas, coal and industrial metal. *Id.* at 103 n.7.

29. Carpenter & Smith, *U.S.-Soviet Joint Ventures: A New Opening in the East*, 43 BUS. LAW. 79, 80 (1987); see Note, *supra* note 19, at 103.

while keeping tabs on Soviet economic and technological developments.³⁰ Also, there is the businessman's lure "of doing deals that haven't been done before."³¹

Through the economic push of joint ventures, *perestroika* may bring more general benefits to the Western world, including a decrease in defense spending, stable relations between the United States and the Soviet Union, and greater social and cultural interactions among citizens of the two nations.³²

B. Set-up Procedures for Joint Ventures

There are three phases of development in establishing a joint venture: discussion, contract negotiations and official registration.³³ Prior to commencing this process, the Western partner should first establish that the potential Soviet partner is legally authorized to operate in the chosen business of the proposed joint venture and is, in fact, a recognized legal entity.³⁴ Upon obtaining this verification of the Soviet partner's legal status, the Western venturer can enter into initial discussions. Successful discussions with the prospective Soviet partner and the relevant government officials lead first to the signing of a protocol or letter of intent.³⁵ It is wise, at this stage, for each of the venturers to gain an understanding of their respective responsibilities and of the general goals of the joint venture.³⁶

The partners must next prepare a feasibility study as part of the official approval process.³⁷ This study can further solidify each partner's

30. JOINT VENTURE GUIDE, *supra* note 5, at 19.

31. Karpelman, *Making Money with the Soviets*, Wall St. J., July 12, 1989, at A16, col. 3.

32. Rogers, *supra* note 1, at 239; see Breslauer, *supra* note 3, at 278-79.

33. Theroux & George, *supra* note 23, at 239-40; see JOINT VENTURE GUIDE, *supra* note 5, at 20-24. For an outline on how to set up a joint venture, see generally Dean, *The Process of Closing the Deal*, in A NEW LOOK, *supra* note 23, at 95.

34. See Theroux & George, *supra* note 23, at 241-42. On October 27, 1990, a presidential decree greatly relaxed this requirement. *Decrees Devalue Ruble: Allow 100% Subsidiaries*, BUS. E. EUR., Nov. 5, 1990 [hereinafter *Decrees Devalue Ruble*]. The new law allows joint ventures with Soviet legal entities and with Soviet natural persons. *Id.* While this change increases the potential partner pool, the Western joint venturer should take great care in assuring that the Soviet partner has adequate financial resources and sufficient access to supplies. *Making a Joint Venture in the Soviet Union*, BUS. INT'L MONEY REP., June 11, 1990.

35. Theroux & George, *supra* note 23, at 239-40.

36. *Id.* at 240-41.

37. *Id.* at 242.

position in regard to the enterprise and allow for a more complete examination of the venture's difficulties.³⁸ Next, the venturers must negotiate and prepare the necessary documents (i.e. the joint venture agreement, the joint venture statute and all ancillary contracts).³⁹ In devising these documents, the negotiators must be sure to fulfill all the requirements of the 1987 Joint Venture Law.⁴⁰ These documents then must be submitted to "a 'higher administrative organ' exercising control over the Soviet partner" for approval⁴¹ and to the USSR Ministry of Finance for registration.⁴² Finally, the venture is announced to the Soviet press.⁴³

The Western partner, however, should not be lulled into a false sense of security by what appears to be an orderly set-up procedure. There are several deficiencies and inconsistencies in the Soviet legislation that must be clarified during the contract negotiation phase.

III. LEGAL CONCERNS FOR WESTERN BUSINESSES

A. Contractual Questions

Under the 1987 Joint Venture Law, the joint venture is considered a juridical person subject to Soviet law.⁴⁴ This raises a number of concerns because the Soviet Union has only the January 1987 decree and its amendments to regulate joint ventures; there is no broader corporate law infrastructure.⁴⁵ There are no guidelines for writing a valid contract⁴⁶ and no explanation of the legal consequences of signing the agreement prior to registration with the authorities.⁴⁷ Also, it is unclear at what point in the development process the joint venture agreement takes effect.⁴⁸

38. *Id.*

39. *Id.* at 240, 243.

40. *Id.* at 243-44.

41. *Id.* at 245.

42. *Id.*

43. *Id.* at 240.

44. JOINT VENTURE GUIDE, *supra* note 5, at 25.

45. *Id.*

46. Osakwe, *supra* note 6, at 103.

47. *Id.* at 104.

48. *Id.* at 103; see Address by Prof. N. Vosnesenskaya, Presentation to the Conference on Negotiating and Implementing Joint Ventures and Other Business Arrangements in the USSR (Feb. 13, 1990) [hereinafter Vosnesenskaya address] (on file at the office of the N.Y.L. SCH. J. INT'L & COMP. L.).

In addition to the joint venture decrees, the venture partners are bound by Soviet tax law, labor law and property law, unless they are exempt by international treaties to which the USSR is party.⁴⁹ The joint venture contract itself is an additional source of legal guidelines.⁵⁰

The foreign partner should be concerned particularly with article 1 of the Joint Venture decree, which allows the Soviets to control joint ventures by enacting "other legislative acts of the USSR and Union Republics."⁵¹ The freedom to enact other laws could provide the Soviets with a powerful tool for wielding control over foreign investors.⁵² Moreover, in instances where the laws enacted by a republic conflict with federal guidelines, it is unclear which takes precedence.⁵³

B. Dispute Settlement

More concern arises upon examination of dispute settlement guidelines. Under article 20 of the 1987 decree, "any dispute arising in the course of the operation of the joint venture may be adjudicated in Soviet courts or . . . before the Soviet Arbitration Court."⁵⁴ It is unclear if this procedure is mandatory, however, because the Soviet conflicts of law doctrine states that the "rights and duties of parties to foreign trade transactions are defined by the law of the place where they were concluded, unless the parties otherwise provide by their agreement."⁵⁵

The Soviet conflicts of law doctrine appears to allow the joint venture partners to utilize the law of a foreign country to regulate their relationship.⁵⁶ For example, the American Trade Consortium in 1988 persuaded its Soviet partner to arbitrate disputes in Swedish courts.⁵⁷ It remains to

49. Hines, *Dispute Resolution and Choice of Law in U.S.-Soviet Trade*, in A NEW LOOK, *supra* note 23, at 125, 136.

50. Osakwe, *supra* note 6, at 55.

51. *Id.*

52. Osakwe, *supra* note 6, at 55.

53. Address by Prof. W. Butler, Presentation to the Conference on Negotiating and Implementing Joint Ventures and Other Business Arrangements in the USSR (Feb. 13, 1990) (on file at the office of the N.Y.L. SCH. J. INT'L & COMP. L.).

54. Osakwe, *supra* note 6, at 64.

55. Hines, *supra* note 49, at 137.

56. *Id.* Swedish law appears to be a good choice for joint ventures because it seems reliable to Western nations and appears acceptable to the Soviets. *Id.* Swedish law, however, does contain a trap for the unwary. *Id.* If the joint venture agreement does not specifically render Swedish choice-of-law doctrines inapplicable, such principles could result in the unwanted implementation of Soviet law. *Id.* at 138.

57. Osakwe, *supra* note 6, at 64 n.237.

be seen, however, if Swedish law always will be acceptable or if the Soviets will try to enforce article 20.⁵⁸

C. Liability

As in many Western industrial democracies, corporate officers in the USSR are liable under criminal, civil and administrative law.⁵⁹ Under criminal law, an officer is accountable for various felonies, including such "economic crimes" as failure to meet quality standards.⁶⁰ Violating a Soviet citizen's labor rights also carries criminal and civil penalties.⁶¹

The joint venture partners' liability to each other is an even more pressing issue because Soviet law is once again unclear on this point.⁶² Under article 18 of the Joint Venture decree, the joint venture is liable for all its own obligations, but not those of its individual partners;⁶³ the partners, in turn, are not liable for the obligations of the joint venture.⁶⁴ However, article 10, which does not set any liability limit for the partners,⁶⁵ appears to be in conflict with article 18.⁶⁶ For example, it states that the joint venture's authorized fund, formed from the partners' contributions, can be "replenished by using profits derived from the business operation of the joint venture and, if necessary, through additional contributions by the partners."⁶⁷ Consequently, the Western partner may be required to contribute assets greater than its equity share, clearly an outcome to be avoided.⁶⁸

D. Termination and Liquidation Procedures

Traditionally, Eastern European joint ventures are terminated after a specified time period set by the joint venture law itself or by agreement of the parties.⁶⁹ Under the Joint Venture decree, the partners can extend

58. Hines, *supra* note 49, at 137 n.10.

59. JOINT VENTURE GUIDE, *supra* note 5, at 28.

60. *Id.*

61. *Id.*

62. Osakwe, *supra* note 6, at 103.

63. *Id.* at 104.

64. *Id.*

65. *Id.*

66. JOINT VENTURES, *supra* note 4, at 147.

67. *Id.*

68. Osakwe, *supra* note 6, at 104-05.

69. Note, *Glasnost: Joint Ventures Now Permitted in the Soviet Union*, 3 FLA. INT'L

that time period if they wish, to avoid untimely dissolution of a successful business;⁷⁰ likewise, they can terminate the venture by mutual agreement at any time.⁷¹ Also, the Soviet government can liquidate the enterprise if it is no longer fulfilling the goals of its charter.⁷² The latter provision should concern the Western partner because it neglects to state the extent of departure from the venture's stated goals necessary to trigger a dissolution proceeding.⁷³ Since there is no existing procedure for appealing this involuntary termination, the foreign partner should negotiate for as much flexibility as possible in the project objectives.⁷⁴

E. Transferability of Shares

The wary Western venturer also should pay close attention to the 1987 Joint Venture Law's provisions on share transfers. Specifically, article 16 of the law expressly states that "[p]artners in a joint venture shall have the right to assign, by common consent, their shares . . . to third parties [and that such] assignment is effected with an endorsement . . . of the USSR Council of Ministers."⁷⁵ Furthermore, article 16 contains the following language: "Soviet partners have the priority right to acquire shares of foreign partners."⁷⁶ Some commentators feel that these conditions (i.e., mutual consent, Ministry approval and a Soviet priority right) allow the Soviets to retain too much power over assignability.⁷⁷ Under this view, the foreign partner could be "forced to sell its shares to the Soviet participant at a lower price than would be available from a third party, and . . . the requirement of two approvals and a Soviet priority right

L.J. 125, 144-45 (1987). For a general account of Eastern European joint ventures, see generally Scriven, *Joint Venture Legislation in Eastern Europe: A Practical Guide*, 21 HARV. INT'L L.J. 633 (1980); Tiefenbrun, *Joint Ventures in the USSR, Eastern Europe, and the People's Republic of China as of December 1989*, 21 N.Y.U. J. INT'L L. & POL. 667 (1989).

70. Note, *supra* note 69, at 145.

71. JOINT VENTURE GUIDE, *supra* note 5, at 32.

72. *Id.*

73. Note, *The New Soviet Joint Venture Law: Analysis, Issues and Approaches for the American Investor*, 19 LAW & POL'Y INT'L BUS. 851, 884 (1987).

74. JOINT VENTURE GUIDE, *supra* note 5, at 32. This is particularly important as it appears that the Soviets take the doctrine of *ultra vires* very seriously. Address by R. Testan, Presentation to the Conference on Negotiating and Implementing Joint Ventures and Other Business Arrangements in the USSR (Feb. 13, 1990) (on file at the office of the N.Y.L. SCH. J. INT'L & COMP. L.).

75. JOINT VENTURES, *supra* note 4, at 147.

76. *Id.*

77. See Note, *supra* note 73, at 885.

[could be] used to force such a sale."⁷⁸ A provision in the December 1988 amendment allows transferability rights to be written in the joint venture agreement; it remains unclear, however, if this provision overrides the earlier requirements of the original 1987 decree when there is a conflict.⁷⁹

To avoid these and related problems, the Western partner must use great care in devising the dissolution passages of the joint venture agreement. In addition to the above concerns, the partner must be sure to include a procedure for valuating assets and liabilities.⁸⁰ Other issues to be covered in the agreement include the transfer of hard currency, the sale of real estate, profit repatriation arrangements and share and loss apportioning.⁸¹

F. Property Rights

Historically, Eastern European joint venture laws have given either all property rights to the joint venture itself or have allowed the parties to maintain ownership of individual contributions.⁸² Under article 17 of the 1987 decree, the joint venture retains all property rights and is protected in the same manner as Soviet state organizations,⁸³ including protection for copyrights and patents.⁸⁴ Furthermore, only specific government organizations are permitted to levy claims against the partnership, and the administrative requisition or confiscation of property is prohibited.⁸⁵

While these provisions appear to provide the venture with a certain amount of protection, technology remains a concern that is not covered by Soviet law.⁸⁶ At this moment, the Western partner should pay careful attention to protecting confidentiality and technology in the agreement; however, a new Soviet intellectual property law may soon eliminate the need for this precaution.⁸⁷

78. *Id.* at 886 (citing J. DOBKIN, J. BURT & S. REYNOLDS, A WESTERN PRACTITIONER'S VIEW OF THE SOVIET JOINT VENTURE LAW 16 (1987)).

79. Osakwe, *supra* note 6, at 90.

80. Note, *supra* note 69, at 146.

81. JOINT VENTURE GUIDE, *supra* note 5, at 32.

82. Note, *supra* note 69, at 135.

83. Note, *supra* note 19, at 113.

84. Note, *supra* note 69, at 135.

85. JOINT VENTURE GUIDE, *supra* note 5, at 31.

86. Theroux & George, *supra* note 23, at 249.

87. *Id.*

G. Capital Contributions

As in the other Eastern Bloc nations, the Soviet joint venture law permits many types of capital contributions.⁸⁸ Because the ruble is not a convertible currency on the world market, the Soviet contribution likely will consist of mineral and property rights,⁸⁹ while the foreign partner will provide hard currency, technology or both.⁹⁰

By referring to world market prices, the 1987 decree allows the partners, through mutual agreement, to appraise their contributions in either rubles or hard currency.⁹¹ Evaluating non-cash contributions may be one of the most laborious portions of the bargaining process.⁹² Specifically, the value of Soviet real estate and natural resources will be difficult to assess because the Soviets traditionally have appraised them below market value by Western standards.⁹³ Likewise, no common pricing standard exists to value the Western partner's "know-how."⁹⁴

Despite these difficulties, methods do exist for appraising each partner's contributed assets.⁹⁵ The Western partner can submit evidence of prior sales and valuations (particularly sales in the East Bloc), sales of comparable companies, production costs, the value of licensing similar technology, and the cost of producing commensurate technology in the USSR.⁹⁶ Also as a starting point, the partners can agree on either an exchange rate or a value for the Soviet partner's contribution.⁹⁷ Therefore, with careful negotiating, it appears that the valuation problems are surmountable.

H. Profits

The ruble's inconvertibility is a major obstacle for both Soviets and Westerners, because both partners want the venture to earn money that can be spent in global markets.⁹⁸ The Western investor's principal

88. Note, *supra* note 69, at 136-37.

89. Comment, *supra* note 12, at 645.

90. *Id.*

91. JOINT VENTURE GUIDE, *supra* note 5, at 22.

92. Theroux & George, *supra* note 23, at 246.

93. Comment, *supra* note 12, at 645-46.

94. *Id.* at 646.

95. Theroux & George, *supra* note 23, at 247.

96. *Id.*

97. *Id.*

98. See Note, *supra* note 19, at 110. The Soviets' need for hard currency began with

objective, however, is to repatriate profits,⁹⁹ while the Soviet investor's main motivation is to increase the government's hard currency supply by keeping profits.¹⁰⁰ With this aim in mind, the Soviets have devised a law to retain hard currency by requiring the Westerner to follow a complicated procedure for repatriation.¹⁰¹

Although the right to repatriate profits is guaranteed by the joint venture legislation,¹⁰² the Western partner can collect only hard currency profits through sales to hard currency markets.¹⁰³ Although there are stores in the USSR that sell products for hard currency,¹⁰⁴ those sales reach only a small percentage of the Soviet domestic market because the average citizen does not possess hard currency.¹⁰⁵ In other words, the foreign investor cannot expect to repatriate profits through sales to the Soviet domestic market.¹⁰⁶

The difficulty of earning spendable profits in the USSR limits the appeal of joint ventures, but they are still the easiest way to acquire access to the vast Soviet domestic market.¹⁰⁷ Exporting, therefore, is a burdensome but necessary tool for the Western investor who wants to earn hard currency while reaching Soviet consumers.¹⁰⁸

The joint venture can earn hard currency directly by developing Western export markets for its product;¹⁰⁹ otherwise, the joint venture can negotiate a counter-trade deal with an outside Soviet manufacturer and earn hard currency by selling that product to the West.¹¹⁰ For example, the first United States joint venture partner, Combustion Engineering, sells processing equipment and computer software to Soviet refineries,¹¹¹ and

the decline of oil prices in the 1980s; 75% to 80% of Soviet export revenue was derived from oil and gas. Recent Developments, *supra* note 18, at 479.

99. JOINT VENTURE GUIDE, *supra* note 5, at 40.

100. *See* Note, *supra* note 19, at 110.

101. Bost, *The 1987 Soviet Joint Venture Law: New Possibilities for Cooperation and Growth in East-West Relations*, 17 DEN. J. INT'L L. & POL'Y 581, 587 (1989).

102. Note, *supra* note 69, at 139.

103. *Id.*

104. *See* Theroux & George, *supra* note 23, at 266. Both Pepsico and McDonald's intend to open some restaurants in the USSR that will accept hard currency only. *Id.*

105. *See id.*

106. Note, *supra* note 69, at 140.

107. *See* Osakwe, *supra* note 6, at 30.

108. *See* Theroux & George, *supra* note 23, at 266.

109. *Id.* at 265.

110. *Id.* at 266-67; *see* Bost, *supra* note 101, at 590-91.

111. Copetas, *Perestroika's Yankee Partner*, N.Y. Times, June 11, 1989, § 6 (Magazine), at 20; *see* Theroux & George, *supra* note 23, at 266.

in return, the company receives payment in Soviet-produced petrochemicals, which it sells to the West for hard currency.¹¹²

One obstacle to counter-trade, however, is the scarcity of Soviet commodities exportable to Western markets.¹¹³ For example, the product may not meet Western quality standards;¹¹⁴ if it does, the Soviet manufacturer may choose to market the product abroad itself, avoiding the joint venture as a "middle-man."¹¹⁵ The Soviet manufacturer most likely will accept a countertrade deal. Consequently, the Western joint venture partner has superior access to hard currency markets.¹¹⁶

If the joint venture earns profits both domestically in rubles and abroad in hard currency, the Western partner may contract to receive a disproportionate share of the hard currency profits.¹¹⁷ Because this method departs from the Soviet aim of acquiring foreign currency, it is likely to be possible only for the short-term.¹¹⁸

The Soviets have not been indifferent to the problems caused by the ruble's inconvertibility. They have expressed a willingness to allow large Western investors, like the American Trade Consortium, to negotiate a special ruble exchange rate.¹¹⁹ The Soviets also have considered implementing a special gold-backed ruble that would be convertible into Western currencies.¹²⁰ In addition, Soviet officials have stated that Moscow's foreign currency auction, formed in 1989 for Soviet state enterprises and organizations, will be open to joint ventures in 1990.¹²¹

112. Copetas, *supra* note 111, at 20.

113. Theroux & George, *supra* note 23, at 267.

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. Carey, *The Soviet Joint Venture Laws: Their Provisions and Purposes*, in A NEW LOOK, *supra* note 23, at 83, 88. For a discussion of the American Trade Consortium, see Clines, *Soviets and 6 U.S. Concerns Sign Trade Pact*, N.Y. Times, Mar. 31, 1989, at D4, col. 3.

120. *Soviet Union Considering Ruble to Lift Trade*, Wall St. J., Apr. 4, 1989, at A18, col. 4; see Fisher, *When a Firm Unreels Secrets of Soviet Joint Venture*, Wall St. J., Aug. 28, 1989, at A1, col. 4. In addition, on October 27, 1990, presidential decree established a new commercial exchange rate for the ruble. *Trade and Payments: Ruble, Foreign Investment, Moves, Trade, Tariff*, COUNTRY REP., Nov. 20, 1990 [hereinafter *Trade and Payments*].

121. See *Bids for Dollars by Soviets*, N.Y. Times, Nov. 11, 1989, at 42, col. 4. A foreign exchange auction open to cooperatives and joint ventures was held on October 9, 1990. *Trade and Payments*, *supra* note 120. Although the turnover at that auction was less than that at the November 9, 1989 auction, the auctions are now becoming more frequent.

Finally, a new convertible currency, other than the ruble, may be created for use in four proposed special economic zones (SEZs).¹²²

Without these schemes either for earning hard currency or overcoming the ruble's inconvertibility, Western businesses may be forced to leave the USSR's vast domestic market untapped.

I. Taxation

The taxation of joint ventures is governed by the joint venture legislation and separate decrees of the USSR Supreme Soviet.¹²³ The Joint Venture decree subjects most joint ventures to a blanket 30% tax on profits.¹²⁴ The law also imposes an additional 20% tax on all profits transferred abroad;¹²⁵ this regulation is designed to serve as an incentive to reinvest in the joint venture.¹²⁶

The joint venture law also outlines other tax-related provisions, including procedures for the joint venture to compute its own tax, as

Id. The dollar rate at the October 9 auction reached as high as Rb. 22.6. *Id.*

122. Theroux, *Special Economic Zones in the USSR: Legal and Practical Issues*, in A NEW LOOK, *supra* note 23, at 59, 72. The Soviets have designated Nakhodka, Vyborg, and Novgorod as sites for these SEZs. *Business News: Special Economic Zones, Joint Ventures, Foreign Deals*, COUNTRY REP., June 19, 1990. The Soviets, however, have been slow to implement these zones. *Id.* Nevertheless, in November 1990, the Russian Republic passed regulations specifying Nakhodka as the first Soviet free trade zone. Torbert, *First Soviet Free Zone Will Give Firms Access to Pacific Basin Markets*, E. ASIAN EXECUTIVE REP., Mar. 15, 1991, at 9.

123. Osakwe, *supra* note 6, at 71.

124. JOINT VENTURES, *supra* note 4, at 150. Under the Law of the USSR on Taxes for Enterprises, Associations and Organizations adopted by the Supreme Soviet on June 14, 1990, joint ventures with less than 30% foreign ownerships are subject to a tax rate of 45%. *New Soviet Tax Code Means MNCs Should Rethink Tax Planning*, BUS. INT'L MONEY REP., July 16, 1990 [hereinafter *New Soviet Tax Code*]. Under this new law, a joint venture can deduct interest paid on bank loans and some indirect labor costs and can carry forward a five-year net operating loss. *Id.*

125. JOINT VENTURES, *supra* note 4, at 151. The new tax code has changed the tax rate on profit distribution from 20% to 15%. *New Soviet Tax Code*, *supra* note 124. Also, a 20% withholding tax was added on interest, rents, royalties and dividends. *Id.* This tax, however, may be reduced by double taxation treaties. *Id.* This tax code also adds some new taxes which are not favorable to joint venturers. *New Corporate Tax Regs Good and Bad for Western JV Partners*, BUS. INT'L MONEY REP., July 16, 1990 [hereinafter *New Corporate Tax Regs*]. Specifically, the new law adds a super profit tax that imposes exorbitant rates: 80% for the first 10% above a unspecified threshold amount and 90% thereafter. *Id.* In addition, a new turnover tax will be imposed on output that will range from 10% to 30%. *Id.*

126. Note, *supra* note 69, at 143.

required.¹²⁷ Payment schedules and late penalties are established,¹²⁸ as well as the venture's right to appeal unsatisfactory tax collection procedures.¹²⁹ The law further allows the Ministry of Finance to decrease the profit tax percentage or exempt the joint venture from taxes altogether.¹³⁰

Initially, the legislation granted a tax exemption during the joint venture's first two years of activity.¹³¹ A second taxation decree amended this to a two-year exemption, beginning only upon receipt of profits.¹³² This change benefits the Western partner because a venture may not generate any profits for its first ten years.¹³³ Notwithstanding the complications of the June 1990 tax law, the tax structure appears fair and shows a Soviet willingness to be open to negotiations. Nevertheless, the Western joint venturer should do a comprehensive case by case tax planning analysis.

IV. OPERATIONAL CONCERNS FOR WESTERN BUSINESSES

A. Corporate Decisionmaking

Under the 1987 decree, at least 51% of the joint venture had to be owned by the Soviet partner.¹³⁴ Western control was limited further by a provision that the joint venture's chairman of the board and general director both be Soviet citizens.¹³⁵ Western investors were unwilling to be minority partners in joint ventures requiring significant amounts of their technological expertise.¹³⁶

The December 1988 amendment, however, modified the requirements; the Western partner could then hold up to 99% of the venture,¹³⁷ and

127. Osakwe, *supra* note 6, at 75. For a discussion of computing taxes, see generally Theroux & George, *supra* note 23, at 255-56.

128. Osakwe, *supra* note 6, at 75-76.

129. *Id.* at 76.

130. Note, *supra* note 73, at 870.

131. Note, *supra* note 19, at 116.

132. *Id.* Under the June 14 legislation, this two-year tax break was eliminated for service and energy extraction joint ventures registered after December 1990. *New Corporate Tax Regs*, *supra* note 125.

133. Osakwe, *supra* note 6, at 73.

134. JOINT VENTURE GUIDE, *supra* note 5, at 33.

135. *Id.*

136. Vaase, *Perestroika and Market Socialism: The Effects of Communism's Slow Thaw on East-West Economic Relations*, 9 NW. J. INT'L L. & BUS. 213, 247 (1988).

137. Osakwe, *supra* note 6, at 88. This requirement was changed further in October

foreign nationals can fill the top executive positions.¹³⁸ While these changes appear to lessen the Soviets' potential control over the Western partner, an additional provision in the December 1988 amendment seems to grant the Soviets greater control. The power of both the board chairman and CEO is lessened by a provision requiring the venture's major operational questions be decided by a unanimous vote of the entire board.¹³⁹ Unanimous voting protects the minority shareholder, whether Western or Soviet, because each board member has veto power.¹⁴⁰ Of further concern to Western investors is the absence of a procedure for removing ineffectual directors.¹⁴¹ This problem may be solved by including a provision for removal procedures in the joint venture contract.

B. Labor Decisions

A difficulty that consistently has affected foreign investments in Eastern Bloc countries is supervising and motivating a local work force traditionally unrewarded for productivity.¹⁴² Under the 1987 decree, the majority of a joint venture's employees had to be Soviets, and the joint venture, therefore, was subject to the stringent requirements of Soviet labor law.¹⁴³

Because these laws provided no mechanism for rewarding or punishing employees based on productivity, new mechanisms were written in the December 1988 amendment to the joint venture legislation.¹⁴⁴ The December 1988 amendment states that all "questions of hiring and discharging (employees), the form and amount of wages, as well as material incentives in Soviet rubles for the workers of a joint venture are decided by the joint venture."¹⁴⁵ This new provision seems to allow the enterprise to set its own employment policy, regardless of its legality

1990. *Decrees Devalue Ruble*, *supra* note 34. The new law allows 100% foreign-owned subsidiaries. *Id.*

138. Osakwe, *supra* note 6, at 88.

139. *Id.* This problem will not occur with wholly-owned subsidiaries. *Id.*

140. *Id.* at 88-89.

141. Note, *supra* note 19, at 114.

142. Note, *supra* note 69, at 132; see Osakwe, *supra* note 6, at 32 n.72.

143. Note, *supra* note 19, at 114-15. Soviet law requires collective bargaining agreements with the relevant trade unions, a minimum wage, fixed work hours, vacation time, social security and insurance. *Id.*; see Osakwe, *supra* note 6, at 93-94.

144. See Note, *supra* note 69, at 133.

145. Theroux & George, *supra* note 23, at 300-01.

under long established Soviet labor law.¹⁴⁶ At the moment, this provision violates the Soviet Constitution; as such, its validity is questionable.¹⁴⁷

The status of non-Soviet workers is an additional concern for joint ventures. The 1987 decree appears to envision very few non-Soviet employees working in the Soviet Union.¹⁴⁸ The joint ventures must pay foreign workers in rubles,¹⁴⁹ and the foreign workers, in turn, must pay Soviet income tax and social security.¹⁵⁰ These requirements represent the Soviet desire to minimize the number of foreign workers¹⁵¹ and may cause additional financial concerns for the foreign partner.

C. Product Quality

Chronic shortages and a lack of competition have created expectations of low product quality among Soviet consumers.¹⁵² The joint venture's product, however, must meet Western quality standards because the Western partner's hard currency earnings depend on the product's marketability abroad.¹⁵³ Also, a Western partner will not want to lend its trade name to an inferior product.¹⁵⁴

At the same time, however, the Western partner will not want to commit itself to excessive financial outlays merely to boost quality standards.¹⁵⁵ For example, not every Westerner can afford to invest as deeply as McDonald's, which spent \$50,000,000 to bring in its own supplies and production equipment for one Moscow restaurant.¹⁵⁶

146. Osakwe, *supra* note 6, at 89.

147. *See id.*; Vosnesenskaya address, *supra* note 48. Professor Vosnesenskaya believes that the amendment causes no conflict since as a decree of the Supreme Soviet, it has the power to override prior laws as far as they apply to joint ventures. *Id.* A prudent joint venturer, however, would be wise to await official confirmation of this view. *Id.* Also, the joint venturer should remain aware of a new minimum wage policy and social security contributions. *Wages and Employment Conditions*, BUS. INT'L FORECASTING, Nov. 1, 1990.

148. Note, *supra* note 69, at 133.

149. *Id.* at 134.

150. *Id.*

151. *See id.*

152. Note, *supra* note 73, at 875.

153. *Id.* at 875-76.

154. *Id.* at 876.

155. *See id.*

156. *See* Keller, *Of Famous Arches, Beeg Meks and Rubles*, N.Y. Times, Jan. 28, 1990, at A1, col. 2.

D. Access to Supplies

Access to supplies in the USSR is tied strongly to product quality. Under the centrally-planned economy, the USSR State Committee for Supplies (Gosnab) allocates all resources available to manufacturers.¹⁵⁷ In November 1988, an amendment to the *Gosnab* decree of June 1987 allowed the joint venture to purchase supplies directly from Soviet producers with either rubles or hard currency.¹⁵⁸

Purchasing supplies still remains difficult, however, because joint ventures have no priority and manufacturers have little left to sell after filling orders for state plans.¹⁵⁹ Access to supplies is hindered further by existing inadequacies in the Soviet transportation system.¹⁶⁰

Importation is an alternate source of supplies,¹⁶¹ and a joint venture may import materials either directly or through a Soviet Foreign Trade Organization (FTO).¹⁶² Payment, however, must be made in convertible currency.¹⁶³ The desirability of imports is further reduced by the imposition of customs duties.¹⁶⁴

E. Price Setting

Serious pricing inconsistencies are created by the ruble's nonconvertibility.¹⁶⁵ The joint venture law allows joint venturers to use world market prices as a model when negotiating with suppliers and customers.¹⁶⁶ This standard, however, does not consider the inappropriateness of world prices in the Soviet market, where the prices of consumer goods remain artificially low due to government subsidies.¹⁶⁷ Pricing strategies must be carefully detailed in the joint venture agreement.¹⁶⁸ Therefore,

157. See Theroux & George, *supra* note 23, at 254.

158. *Id.*

159. *Id.* at 255.

160. See Note, *supra* note 69, at 138.

161. JOINT VENTURE GUIDE, *supra* note 5, at 36.

162. *Id.* See generally Rabinovitch, *The Procedure for Signing with Soviet Foreign Trade Organizations*, 22 INT'L LAW. 143 (1988).

163. JOINT VENTURE GUIDE, *supra* note 5, at 36.

164. Theroux & George, *supra* note 23, at 256.

165. Note, *supra* note 73, at 863.

166. JOINT VENTURE GUIDE, *supra* note 5, at 36.

167. See Carpenter & Smith, *supra* note 29, at 88.

168. *Id.*

the Western partner must set a price that is competitive on the world market without being undercut on the Soviet domestic market.¹⁶⁹

V. CONCLUSION

Because Soviet legislation allowing joint ventures is only five-years old, it is still too early to predict solidly the true viability of foreign-Soviet business partnerships. One thing that remains clear is that the Soviet Government truly desires improved business relations with the West.¹⁷⁰ The Soviets appear willing to adjust legislation to better suit a foreign partner's interests.¹⁷¹

Soviet flexibility is evidenced specifically by the amendments to the original Joint Venture decree, which removed provisions perceived by wary Western investors as prohibitive. In addition, the Soviets are considering other measures to ease access to their domestic market, including devaluing the ruble,¹⁷² granting foreigners access to the newly-created Soviet foreign exchange auction¹⁷³ and creating special economic zones modeled after those in the People's Republic of China.¹⁷⁴

Western interest in joint ventures should continue in the coming years as the Soviet legislation becomes increasingly accommodating and thorough. Businesses choosing to pursue joint ventures now, however, must be careful to tailor and document each aspect of the agreement.¹⁷⁵

Furthermore, the prospective investor must remember that the future of a joint venture may depend ultimately upon the success of political and

169. See Theroux & George, *supra* note 23, at 255.

170. Osakwe, *supra* note 6, at 100.

171. *Id.* at 101.

172. Gumbel, *Soviets to Devalue Ruble by 50%, Alter Tariffs to Boost Economy*, Wall St. J., Dec. 12, 1988, at A9, col. 1.

173. Copetas, *supra* note 111, at 42.

174. See Theroux, *supra* note 122, at 72; Gumbel, *Soviets Planning Economic Zones To Draw More Foreign Investment*, Wall St. J., May 2, 1989, at A3, col. 1.

175. Toop, *Practical Aspects of Initiating Contact, Submitting Proposals and Negotiating Joint Venture Agreements in the USSR*, in A NEW LOOK, *supra* note 23, at 109, 123. It appears that Western firms are increasingly deciding to pursue joint ventures. *Id.* By January 1, 1990, the number of registered ventures surpassed 1300. See O. Kocherga, Presentation to the Conference on Negotiating and Implementing Joint Ventures and Other Business Arrangements in the USSR (Feb. 13, 1990) (on file at the office of the N.Y.L. SCH. J. INT'L & COMP. L.); see also Pear, *Chevron and Soviets to Work Toward Oil Venture*, N.Y. Times, June 3, 1990, at A13, col. 1. But see Berg, *Business Wary of Gorbachev Pitch*, N.Y. Times, June 7, 1990, at D1, col. 3.

economic reform within the Soviet Union.¹⁷⁶ Currently, the centralized government is threatened by increasingly powerful nationalistic movements in more than one half of the USSR's fifteen republics.¹⁷⁷ Hence, there is growing uncertainty and pessimism among the Soviet citizenry regarding Gorbachev's reform process and its likelihood for success.¹⁷⁸

Nevertheless, it is important to realize that joint ventures represent historic opportunities to unite the East and West in ways unthinkable during the cold war era.¹⁷⁹ This in itself justifies the continuing efforts of both sides to make joint ventures a success.

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176. Comment, *supra* note 12, at 656.

177. Watson, *supra* note 9, at 20. Leading the charge to independence, Lithuania declared its independence on March 11, 1990. *Id.* Estonia and Latvia followed with less confrontational moves. *Id.* Gorbachev reacted harshly to all three challenges. *Id.* Additionally, the Ukraine, Moldavia, Georgia and Azerbaijan present potential problems for Moscow. *Id.* The Russian Republic also presents difficulty for Gorbachev because of Boris Yeltsin's recent winning election bid for the presidency of the Republic. See Clines, *In Moscow, Yeltsin Has a Summit to Himself*, N.Y. Times, § 4 (The Week in Review), at 1.

178. Keller, *Gorbachev's Anti-Magic*, N.Y. Times, Sept. 25, 1989, at A1, col. 5; see Watson, *supra* note 9, at 19. Panic buying swept across Moscow recently in response to an economic reform proposal. Anderson, *Too Little and Too Late?*, NEWSWEEK, June 4, 1990, at 22.

179. Bost, *supra* note 101, at 599.