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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. In this note, I will argue that the new strategic industries 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 Organization for Economic Co-operation and Development and will likely help promote foreign investment in Russia.

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I. Introduction

Some commentators have criticized Russia’s new law regulating foreign investment in its strategic sectors.¹ In this Note, I 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 is generally consistent with Russia’s goals of encouraging the growth of foreign investment and meets criteria for such legislation proposed by the Organization for Economic Co-operation and Development.²

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.³ From 2000 to 2007 the influx

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of foreign direct investment (FDI) increased by approximately 800 percent.\(^4\) The level of FDI as a percentage of gross domestic product (GDP), however, is still low compared to other developed economies.\(^5\) 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.\(^6\) 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.\(^7\) Russian President Vladimir Putin first spoke to the need for such a law in his annual address to the Federal Assembly in 2005.\(^8\) The State Duma and Federation Council passed the final draft of the bill – "On Foreign Investments in Strategic Sectors of the Russian Economy" (strategic sectors legislation) – in April 2008, and it was signed into law by President

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Noting that the initial role of the ruble devaluation and rise in oil prices has been replaced by increases in consumer demand and investment as the main drivers of growth.


\(^5\) Economist Intelligence Unit, *supra* note 4, at 173.

\(^6\) “President Welcomes Foreign Investment,” *The St. Petersburg Times*, September 25, 2007. President Putin has said, “We expect that private investors will play an increasingly noticeable and leading role in the large-scale modernization of the economy.”


Putin on May 5, 2008.\textsuperscript{9} The strategic sectors law restricts the level of foreign investment in forty-two different types of businesses, establishes procedures to approve such investments, and spells out the rights and obligations of foreign investors.\textsuperscript{10} The law also resembles the regulatory framework that already exists in many developed countries.\textsuperscript{11} Indeed, in recent years many 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.\textsuperscript{12}


\textsuperscript{10} Tai Adelaja and Natalia Krainova, “Strategic Sectors Bill Clears 2nd Reading,” \textit{The Moscow Times}, March 24, 2008.

\textsuperscript{11} See, Organization for Economic Co-Operation and Development, \textit{supra} note 2. Discussing the general increase in the regulation of strategic industries in developed countries.

\textsuperscript{12} Nikolaus von Twickel, “Barriers Going Up All Over Europe,” \textit{The Moscow Times}, March 13, 2008. The advent of sovereign wealth funds – state-controlled pools of capital used for strategic investments abroad – has alarmed many policymakers in developed economies. Often, legitimate security concerns along with populist sentiments cause politicians to oppose takeovers of domestic companies.
b. Foreign Direct Investment Defined

FDI generally “occurs when a foreign investor exerts direct control over domestic assets.” 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 can acquire ownership over an existing business. This Note is only concerned with the second type of investment – acquisitions over existing enterprises – which is the subject matter of the strategic sectors law.

This Note will have four sections: Section two will describe the growth and importance of FDI in the Russian economy; Section three will look at the existing legislative and regulatory framework regarding foreign investment; Section four will examine the strategic sectors law; and, lastly, Section five will analyze the likely impact of the strategic industries law and argue that it conforms to criteria proposed by the Organization of Economic Co-Operation and Development.


14 Graham, et al, supra note 13, at 2. The distinction is often referred to as ‘greenfield’ investment versus ‘mergers and acquisitions.’ The definition of FDI under Russian law will be discussed below.
II. Background & Discussion

a. Foreign Investment in Russia

The Russian economy has enjoyed robust growth over the past seven years. From 2000 to 2006, Russian GDP has enjoyed an annual growth of approximately 7 percent\textsuperscript{15} and reached 8 percent in 2007.\textsuperscript{16} In the past eight years, economic output has grown 70 percent, household consumption 115 percent, and wages have risen eightfold.\textsuperscript{17} A variety of factors have 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 commodities prices.”\textsuperscript{18}

FDI inflows to the Russian economy have also accelerated, growing from an average three billion dollars per year from 1998-2002 to nearly twenty-nine billion dollars in 2006.\textsuperscript{19} At approximately 10 percent, the share of FDI inflows as a percentage of GDP is “still one of the lowest . . . among all 28 countries of the transition region.”\textsuperscript{20}

Indeed, Russia’s economic recovery has been largely “investment-free … thanks to the


\textsuperscript{18}U.S. State Department, Background Note: Russia (2007), http://www.state.gov/r/pa/ei/bgn/3183.htm (last visited April 7, 2008).

\textsuperscript{19}Economist Intelligence Unit, supra note 4, at 173.

\textsuperscript{20}Id. at 173. The term ‘transition region’ refers to the formerly communist countries sometimes called the Newly Independent States (NIS).
country’s extensive Soviet-era infrastructure and underutilized capacity.” Nonetheless, investment has in recent years “join[ed] consumption as a pillar of growth.” Much of the FDI going into Russia is limited to certain sectors and certain partners. For example, 49 percent of Russia’s FDI inflows are into the mining and quarrying sectors and two-thirds of FDI is from Cyprus and Netherlands, which likely results from domestic firms reinvesting their own capital that is held abroad. Also, the recent growth in FDI “does not necessarily reflect a radical change in investors’ perceptions of the business climate.” Indeed, a survey in 2005 found that, among direct investors, “there is widespread apprehension, and uncertainty as regards the future, in key areas of the operating environment.” Furthermore, “[m]ore international investment is needed

21 MacFarquhar, supra note 17, at 34.

22 Pekka Sutela, “Economic Growth Remains Surprisingly High,” Russian Analytical Digest 3 (April 2, 2008). Russia’s initial recovery was primarily fueled by a cheap ruble and high oil and gas prices. Russia’s continuing growth and development is an investment-fueled expansion.

23 Sutela, supra note 22, at 3. “[T]he volume of investment is not sufficient and it is excessively concentrated in a few branches of the economy.”


to support Russia’s economic development and diversification.” The productivity gains experienced in the recovery period were mostly based on underutilized capacity and increased investment will be necessary to raise productivity levels in the future. As Russia’s economy “has returned to its pre-transition magnitude in real terms … infrastructure bottlenecks have begun to appear.” And though 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.”

Openness to foreign investment is not shared by all in the Russian government. Debates over strategic policies pit economic nationalists from the security services against economic internationalists from the economics and finance ministries. Including lack of confidence in the rule of law, bureaucracy and corruption, lack of administrative uniformity and predictability, and an uncertain policy environment.


28 World Bank, Russian Economic Report – No. 15 13 (November 2007). Investment will increase productivity not only with increases in the physical productive capacity, but also through the introduction of new technologies and management methods that increase labor efficiency.

29 MacFarquhar, supra note 17, at 34. As Russia reaches and surpasses its pre-collapse level of GDP, its existing productive capacity will become overtaxed and its need for investment will grow.


31 See, e.g., Gosling, Tim. “39 Steps Down for the Cabinet’s Liberal Faction?” Business New Europe, July 20, 2007, http://www.russiaprofile.org/page.php?pageid=Business&articleid=a1184930779 (last visited April 7, 2008). 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
Nonetheless, the current Russian government has recognized the need for foreign investment, and promoting FDI remains its official policy.\textsuperscript{32} Russia’s new president – Dmitry Medvedev – will likely prioritize FDI to an even greater extent than did President Putin.\textsuperscript{33} Medvedev has stressed that Russia’s development strategy should be guided by the “four I’s” – “Institutions, Infrastructure, Innovation, Investment.”\textsuperscript{34}

One example of an area where Russia desperately needs investment – both foreign and domestic – is in its power grid. Up until recently, Russia’s power grid is administered by the state monopoly, Unified Energy System (UES), which controlled “580,000 workers, 440 power stations, and 2 million miles of power lines.”\textsuperscript{35} Despite these impressive resources, the company was unable to meet increasing demand, even in large Russian companies. See, Ian Bremmer and Samuel Charap, “The Siloviki in Putin’s Russia: Who they Are and What they Want,” \textit{Washington Quarterly}, Winter 2006/2007, www.twq.com/07winter/docs/07winter_bremmer.pdf (last visited April 7, 2008). Western commentators, however, tend to exaggerate the power of the siloviki and diminish the influence of economic liberals in the Russian government.

\textsuperscript{32}“President Welcomes Foreign Investment,” \textit{supra} note 6.


the city of Moscow, which faced a huge energy deficit in the cold winter of 2006.\textsuperscript{36} For this reason, the country has a pressing “need to attract massive amounts of foreign investment – around $100 billion between now [2007] and 2010 – to renovate Russia’s crumbling electricity infrastructure.”\textsuperscript{37} Furthermore, the hope is not only to obtain access to money, “but also promote economic efficiency and transparency.”\textsuperscript{38} 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.”\textsuperscript{39} The strategy appears to be working – in March 2008 Electricite de France and a Russian partner announced plans to acquire one of UES’ major utilities.\textsuperscript{40} The example of UES is likely similar to the situation with the rest of Russia’s infrastructure, including pipelines,\textsuperscript{41} railways and water ports,\textsuperscript{42} and airports.\textsuperscript{43} Some Russian officials have


\textsuperscript{37}Bush, \textit{supra} note 35.

\textsuperscript{38}Id.


\textsuperscript{41}Pat Davis Szymczak, Sergei Korobov, and Vlad Konstanza, “Russia Gas Tap Turns to China,” \textit{Oil & Gas Eurasia}, June 2006, http://www.oilandgaseurasia.com/articles/p/9/article/167 (last visited April 7, 2008). “Whether Russia looks East or West, it needs big investment to grow its production and to transport that
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 from the power grid. 44 Indeed, because an “economy depends on infrastructure to facilitate the flow of goods, people, information and energy,” poor production reliably to market. This relates to geological exploration, the opening of new fields, to infrastructure construction, and to the development and purchase of new equipment and technologies. And production isn’t everything. Experts suggest that Russia loses about 30 bcm of gas a year during transport because of deteriorating pipelines.”

42 World Bank, *Transport – Russia*, (January 3, 2005), http://go.worldbank.org/SGG4WO6750 (last visited April 7, 2008). “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…[and] Russia’s remaining seaports have suffered from lack of investment and modernization…[and] they need to be upgraded physically and technically.”

43 Bojan Soc, “MAI: Ulan Ude Airport Holds Huge Potential,” *Moscow News*, April 4, 2007, http://www.mnweekly.ru/business/20071004/55280527.html (last visited April 7, 2008). Discussing the first-ever purchase of a Russian airport by a foreign investor. “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.”

infrastructure can increase costs and cripple the economy. In the case of Russia, “investment is needed … for repairing deficiencies in infrastructure.”

b. Existing Legal and Regulatory Framework

The major law governing the rights and protections of foreign investors in Russia is “On Foreign Investment in the Russian Federation” of July 1999. The law is the “core legislation governing the national regime of foreign investments in Russia.” 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 (e.g., corporations), foreign organizations that are not judicial persons (e.g., limited liability partnerships), international organizations, and foreign states. 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.”

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48 Glinkin, supra note 47.


investment (i.e., FDI) is defined as “the acquisition by a foreign investor of at least 10 per cent stake … in the … capital of a commercial organization.” 51 Articles 4 – 15 of the law define the various guarantees for foreign investors, which include national treatment 52 except when federal law provides otherwise, legal 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. 53 Significantly, several provisions (e.g., 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.” 54 At the time that the law was passed, some observers raised concerns with these caveats and pointed out 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.” 55 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. 56 In many respects, however, “the 1999 Law is little

51 On Foreign Investment, supra note 49, Article 2.

52 National treatment means that a foreign investor is treated the same as a domestic investor, except for when the law provides otherwise.

53 On Foreign Investment, supra note 49, Articles 4-15.

54 Id.


56 On Foreign Investment, supra note 49, Articles 2, 4-15.
more than a broad statement of principles.”

A multitude of other laws often supplement the Law on Investment in regulating the activity of investors. Lastly, “there are many restrictions on foreign investment in the armaments industry … on exploration and exploitation of certain natural resources, transportation and ownership of land.” 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.

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 investments.” 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.” A recent World Bank study found


58 Id. Particularly, the law On Investment Activity in the 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,” etc.

59 Id., at 454.

60 Id., at 464.


62 The PBN Company, Russia Investment Destination 2006 7 (May 2006).
that, in order to obtain a license to build a warehouse, an investor must complete 54 procedures over a period of 704 days. With regards to the court system, foreign firms “are dissatisfied with a perceived lack of uniformity and impartiality and especially with the insufficient rapidity and effectiveness” of the courts. Recently, there have also been growing concerns regarding undue interference from the security services in Russian business. For example, in March 2008, agents from the Federal Security Service (FSB) raided the Moscow offices of British Petroleum (BP). The agents were reportedly searching for documents pertaining to Gazprom, the state-owned natural gas monopoly. 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.”

Though most investors did not think that the Russian government

63 World Bank Group, Doing Business 2008 Russia 6 (2007). Indeed, Russia ranks second to last out 178 countries when it comes to the ease of obtaining licenses.

64 Organization for Economic C-operation and Development, supra note 25, at 27.

65 See, e.g., Lilia Shevtsova, Russia: Lost in Transition 96-103 (Carnegie Endowment for International Peace 2007). “Corruption and criminal activity by representatives of the Interior Ministry, the FSB, the Tax Department, and the prosecutor’s office beggar belief.”


68 Id. TNK-BP is the joint venture between BP and several Russian billionaires. It is the single largest British investment in Russia. A tax evasion investigation was also opened as well. 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. In either case, the FSB’s role was clearly not benign. Miriam Elder,
would expropriate TNK-BP, many concluded that the pressure on the company “may 
force [BP] … to cede control of Russia’s third-largest oil producer to state-backed 
Rosneft or Gazprom before long.”

Most recently, after TNK-BP CEO Robert Dudley was forced to leave Russia after authorities denied his visa application, he accused various government agencies of abusing their power in dealing with the company.

Another example of the erratic investment environment in Russia that received much press attention was the case of Motorola’s missing phones in 2006. In March 2006, the Interior Ministry of Russia seized 167,000 mobile phones from Motorola at the Sheremetyevo Airport in Moscow. 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.”

The Ministry later returned 117,519 of the phones without an explanation for the seizure or what happened to the other 50,000 phones. Eventually, the authorities reported that

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72 Myers, supra note 71.

73 Id.

74 Id.
the 50,000 handsets had been “destroyed,” though investigators began to look into whether they had in fact been sold on the black market. Commentators argued that the Motorola ordeal was symptomatic of the general level of corruption and unfairness afflicting businesses operating in Russia.


d. The Strategic Sectors Law

i. Why a Strategic Industries Law?

Russian authorities first suggested the 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. The Siemens fiasco began in 2004-05 when that company sought to acquire Russian company Interros’ shares of Power Machines, which would have given Siemens a 74 percent share in the company. 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. Soon thereafter, officials publicly came out against the deal and the State Duma adopted a proposal “which said that the sale of PM [Power Machines] is threatening the defense and economic security of the country.” The Duma deputies based their resolution on the fact that Power Machines is a main producer of turbine engines used in military vehicles. 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.” 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.” Specifically, the FAS found that the proposed deal would violate the law “On Competition and the Limitation of Monopolistic Activity on Commodity Markets.” 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

79 Yambaeva, et al, supra note 78.
80 Id.
81 Id.
82 Id. By the lack of a ‘legal base,’ Khristenko was referring to the fact that the current foreign investment law does not speak to national security concerns or limit foreign investment on this basis. Indeed, “[t]here 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.” Satrom, supra note 61, at 2.
84 Press-sluzhba FAS Rossii, supra note 83.
military goods.” In the aftermath of – literally, days after – the Siemens affair, President Putin addressed the need for a strategic sectors law for the first time ever. In his Annual Address to the Federal Assembly on April 25, 2005, Putin spoke about foreign investors:

   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 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.

Thus, the current strategic industries legislation arose as a response to the lack of a legal framework for investment in strategically significant Russian companies.

ii. The Strategic Sectors Law’s Status

85 Id.

86 Annual Address to the Federal Assembly, supra note 8. In other words, Putin was advocating 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.
Though Putin first proposed the idea of a strategic industries law in 2005, work on the bill did not start until July of 2007. During the summer of 2007, various committees reviewed and finalized the bill for its first reading by the Duma on September 13, 2007. 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 spring of 2008. The delay was likely due to the Duma elections in December of 2007 and the Presidential election in March of 2008. The second reading of the legislation, which included many changes, passed the State Duma on March 21, 2008. Finally, the legislation passed its third reading on April 2, 2008, the Federation Council a few weeks later, and was signed into law by President Putin on May 5, 2008.


88 Perechen’ Dokumentov, supra note 87. Russian legislation, as in the United States, goes through several ‘readings’ where the committee with responsibility for the legislation revises the text based on the suggestions of the Duma and other lobbying interests. Generally, a bill will go through three readings before a final vote.


## iii. Who is Regulated

The strategic sectors law regulates two groups of investors. The first group comprises businesses owned or controlled by foreign 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 either type of companies’ directors.\(^93\) Significantly, these public companies are generally forbidden from acquiring control over any of the types of businesses covered by the legislation.\(^94\) The second group includes organizations controlled by foreign investors that wish to acquire control of a strategic business or subsoil company.\(^95\) The definition of foreign investor is regulated by the existing law on foreign investment.\(^96\) The Law on Foreign Investment’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.\(^97\) The law defines control as the ability of a foreign investor to make decisions for the business through various

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\(^93\) *Federal’nyi Zakon*, supra note 1, Article 2, Section 3. The ability to block decisions is defined as the ability to command three-fourths of the votes of directors, Article 3, Section 1, Subsection 5.

\(^94\) *Id.*, Article 2, Section 2.

\(^95\) *Id.*, Article 3, Section 1, Subsection 3.

\(^96\) *Id.*, Article 3, Section 2.

\(^97\) *Law on Foreign Investment*, supra note 49, at Article 2.
means. 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. In the case of subsoil companies, control includes ownership of ten percent of the company’s shares, the right to name ten percent of the company’s board of directors, or the right to make management decisions.

iv. What is Regulated?

Perhaps the most controversial feature of the strategic sectors law is the list of industries falling under the law’s regulations. In fact, 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: work with hydrothermological processes and phenomena; work with geophysical processes and phenomena; work with infectious diseases and pathogens; 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

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98 Federal’nyi Zakon, supra note 1, Article 3, Section 1, Subsection 3. The law applies to foreign investors who exercise control either directly or through third parties.

99 Id., Article 5, Section 1.

100 Id., Article 5, Section 3.

101 See, e.g., Gosling, supra note 31.

102 Federal’nyi Zakon, supra note 1, Article 6.
radio stations; publishing companies; and the study and extraction of subsoil resources.\textsuperscript{103} The television and radio stations covered in the law consist of those that reach at least half of the population.\textsuperscript{104} The telecommunications providers that the law regulates include those that occupy a “dominant position” in their respective industries.\textsuperscript{105} Also, regulated publishing companies are limited to those capable of printing 200 million reproductions per month\textsuperscript{106} and periodicals with a distribution of one million copies.\textsuperscript{107} Perhaps the most controversial aspect of the list is the inclusion of natural monopolies.\textsuperscript{108} Natural monopolies are defined in an existing law and include pipelines, rail transportation, services at sea and airports, and the electricity and heating grids.\textsuperscript{109} Several categories of natural monopolies – electricity, heating, and postal services – were exempted from the legislation.\textsuperscript{110} The inclusion of natural monopolies on the list was strongly resisted by then-Minister of Economics German Gref, due to the extreme need

\textsuperscript{103} Id.

\textsuperscript{104} Id., Article 6, Sections 34-35.

\textsuperscript{105} Id., Article 6, Section 37. A company holds a ‘dominant position’ in an industry if it possesses a fifty percent market share or if the Federal Anti-Monopoly Service has designated it as holding such a position. \textit{See, Federal’nyi Zakon O Zashchite Konkurentsii}, No. 153-FZ of July 26, 2006, Article 5, Section 1.

\textsuperscript{106} Id., Article 6, Section 41.

\textsuperscript{107} Id., Article 6, Section 42.

\textsuperscript{108} Id., Article 6, Section 36.


\textsuperscript{110} Federal’nyi Zakon, supra note 1, Article 6, Section 36.
for investment in those sectors.\textsuperscript{111} Indeed, President Putin himself has stressed the need for more foreign investment in infrastructure and has pledged to liberalize those sectors.\textsuperscript{112} Some have also criticized the inclusion of telecommunications companies on the list, because it will allegedly “hamper investment on the communications market and will no doubt cause stagnation in the industry.”\textsuperscript{113} Lastly, the addition of newspapers, publishers, and fisheries to the list similarly “raised eyebrows and worried foreign investors.”\textsuperscript{114}

v. \textit{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

\textsuperscript{111} Gosling, \textit{supra} note 31. At a February 2007 cabinet meeting, Gref reportedly said, “It is wrong to stoop to restricting investments in infrastructure.” Gref was replaced during a cabinet shakeup in September 2007.

\textsuperscript{112} “President Welcomes Foreign Investment,” \textit{supra} note 6.


\textsuperscript{114} Adelaja, \textit{supra} note 10.
the purchasing and target companies, and proof of the applicant’s registration in Russia.\footnote{\textit{Federal’nyi Zakon}, supra note 1, Article 8, Section 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 (i.e., 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.}

The government’s mechanism for evaluating applications involves two state entities – the Representative Body and the Commission. Though the law simply says the Representative Body will be an executive organ, the Federal Anti-Monopoly Service (FAS) ended up as the lead agency.\footnote{The PBN Company, \textit{Foreign Investment in Russian Strategic Industries: Duma Approves Bill 2} (April 2008). “The FSB [Federal Security Service] and 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.”} The law also spells out the right of the Federal Security Service (FSB) to conduct “operational search measures” in order to determine whether or not an investor has control over a strategic business.\footnote{\textit{Federal’nyi Zakon}, supra note 1, Article 13, Section 6. The Russian phrase used – \textit{operativno-rozysknye meropriyatiya} – does not translate well. It is defined and regulated by the law \textit{On Operational Search Measures}, FZ-144, July 5, 1995. 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, etc.} The Representative
Body’s main functions include registering the application, establishing whether the applicant 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. 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.

The Commission makes the final decision regarding a proposed deal on the basis of the Representative Body’s recommendation. The Commission will deny a proposed deal only if the commercial organization possesses specified characteristics and the completion of the deal would damage the national security interests of Russia. Also, a deal can be declined if the applicant refuses to accept the obligations set out in the legislation. The entire application process shall consist of three months, though, in exceptional circumstances, it may be extended by three months through a decision of the Russian government.

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118 Id., Article 9, Section 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.” Article 3, Section 1. The characteristics upon which the threat assessment is based will be discussed in the next section.

119 Id., Article 9, Section 2.

120 Id., Article 11, Section 1.

121 Id.

122 Id., Article 12, Section 2.

123 Id., Article 11, Section 4.
The strategic sectors law establishes consequences for non-compliance and the right of judicial review. Deals completed in violation of the law are of no legal effect and investors who violate the law or who materially or repeatedly fail to comply with the obligations under the law will lose their voting rights in shareholder meetings. Finally, an investor can appeal in the courts either if the Representative Body fails to examine the application or if the Commission issues a denial.

vi. How are Applications Judged?

The strategic sectors law also sets out the criteria for determining whether or not a deal threatens Russia’s national security. Specifically, there are twelve possible characteristics of a commercial organization that are relevant to this question, mostly

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124 Id., Article 15, Section 1-2.
125 Id., Article 10, Section 7.
126 Id., Article 11, Section 7. In this case, the investor must appeal to the Supreme Arbitrazh Court of the Russian Federation. 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. The Supreme Arbitrazh Court is essentially the court of final appeal for all commercial disputes in the country. See, William Burnham, supra note 50, at 50. 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).
relating to work with military secrets, export-controlled products, and military contracts.\textsuperscript{127} A law enforcement agency (i.e., FSB) investigates these various characteristics and provides its conclusions to the Representative Body.\textsuperscript{128} If the organization has any of the 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.\textsuperscript{129} 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.\textsuperscript{130} Finally, any obligations that are placed on the investor should be included in the Commission’s decision.\textsuperscript{131}

\textsuperscript{127} \textit{Federal’nyi Zakon}, supra note 1, Article 10, Section 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; the company is registered as a natural monopoly; company is registered 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.

\textsuperscript{128} \textit{Id.}, Article 10, Section 3.

\textsuperscript{129} \textit{Id.}, Article 12, Section 1.

\textsuperscript{130} \textit{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.

\textsuperscript{131} \textit{Id.}, Article 12, Section 4.
vii. 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.\textsuperscript{132} The Committee’s report expressed concern over several aspects of the law, including the “very difficult” process for approving a deal and the vagueness of certain definitions.\textsuperscript{133} The Committee concluded with several recommendations to both the State Duma and the government.\textsuperscript{134} 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.\textsuperscript{135} The recommendations made to the government included clarifying the position of the Commission and 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.\textsuperscript{136} 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.


\textsuperscript{133} Komitet po Promyshlennosti, Stroitel’stvu I Naukonomkim Tekhnologiyam, supra note 132.

\textsuperscript{134} Id.

\textsuperscript{135} Id.

\textsuperscript{136} Id.
viii. Major Changes 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.\footnote{Federal’nyi Zakon, supra note 1, Article 6.} The sectors that were added to the second draft of the law include major television stations,\footnote{Id., Article 6, Section 34.} major radio stations,\footnote{Id., Article 6, Section 35.} large printing\footnote{Id., Article 6, Section 41.} and publishing\footnote{Id., Article 6, Section 42.} houses, the fishing industry,\footnote{Id., Article 6, Section 40.} and the telecommunications industries.\footnote{Id., Article 6, Section 37.} Second, and perhaps most significantly, the second draft of the legislation added strategic subsoil resources to its list of covered industries.\footnote{Id., Article 6, Section 39.} Originally, a separate bill was planned to regulate strategic subsoil resources, but it was ultimately incorporated into the strategic industries law.\footnote{Medetsky, supra note 89.} Also, though the law does not apply to previous deals, the second draft requires foreign investors who own five percent

\footnote{Federal’nyi Zakon, supra note 1, Article 6.}  
\footnote{Id., Article 6, Section 34.}  
\footnote{Id., Article 6, Section 35.}  
\footnote{Id., Article 6, Section 41.}  
\footnote{Id., Article 6, Section 42.}  
\footnote{Id., Article 6, Section 40.}  
\footnote{Id., Article 6, Section 37.}  
\footnote{Id., Article 6, Section 39.}  
\footnote{Medetsky, supra note 89.}
or more of a strategic company’s shares to notify the Representative Body within eighty
days of the law’s enactment. Furthermore, the second draft requires investors to
inform the Representative Body any time they acquire five 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. Certain natural monopolies – specifically,
electricity, heating, and postal services – were removed from the law in the second
draft. Lastly, the second draft tasked the Supreme Arbitrazh Court with taking appeals
from foreign investors whose applications were denied by the Commission.

ix. Initial Implementation of the Strategic Sectors Law

Since its passage, the Russian government has fully implemented the strategic
industries law and begun examining applications from foreign investors. On July 6,
2008, the government issued a decree establishing the administrative framework for the
law’s enforcement. The decree explicitly named the Federal Anti-Monopoly Service

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146 Federal’nyi Zakon, supra note 1, Article 16, Section 3. Based on the date that Putin signed the bill into
law, this deadline would be July 24, 2008.
147 Id., Article 14.
148 Id., Article 6, Section 36.
149 Id., Article 11, Section 7.
150 Medetsky, Anatoly, “Test Run for Strategic Industries Law,” The Moscow Times, August 20, 2008,
151 Postanovlenie Pravitel’stva Rossiiskoi Federatsii O Pravitel’stvennoi Komissii po Kontroliu za
Osushchestvleniem Inostrannykh Investitsii v Rossiiskoi Federatsii, No. 510 of July 6, 2008 [hereinafter
as the Representative Organ, something that was left undefined in the law. The decree also established the Commission and detailed its functions. 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. Also, the decree provided that the Commission’s final decisions on an application will be decided by a simple majority vote. Finally, a government regulation from the same day established the membership of the Commission. The Commission’s most important members are Prime Minister Vladimir Putin (Chairman), First Deputy Prime Minister Igor Shuvalov (Deputy Chairman), and Head of the Federal Anti-Monopoly Service Igor Artemyev (Secretary).

Though no applications have completed the full application and evaluation process under the strategic industries law, at least three investors have initiated requests. Svetlana Levchenko, the Chief of the Department of Foreign Investment Control at the FAS, said that the number of requests have been “modest, but they show

152 Postanovlenie, supra note 151.
153 Id.
154 Id. These powers mirror those set out in the law itself.
155 Id.
157 Rasporiazhenie, supra note 156. The other fourteen members consist of the heads of various government ministries and agencies.
158 Medetsky, supra note 150.
that the law has begun operating.”  

Indeed, the first sitting of the Committee could possibly occur in the middle of September.  

Two of the current applicants are reportedly De Beers and Alenia Aeronautica. De Beers wishes to buy a 49.9% stake in Arkhangelskgeoldobycha (AGD), a subsidiary of the Russian oil company Lukoil. The Italian Alenia Aeronautica, meanwhile, has applied to acquire a twenty-five percent plus one stake in Sukhoi Civil Aircraft, the civilian aircraft arm of Sukhoi Company. The outcome of these two applications will provide investors with the first guidance regarding the strategic sectors law’s application.

x. Commentary on the Strategic Sectors Law

The strategic sectors law has elicited more commentary than is usual for Russian legislation. Some observers have criticized the law for being restrictive and for involving the secret services in business. For example, one Russian commentator noted that “the

159 Id.
161 Tutushkin, supra note 160.
162 Id.
former Chekists will have a full carte blanche to interfere in the economic sphere.”

Others have claimed that the strengthened strategic policies contained in the law will lead to a decline in foreign investment. Still others criticized the inclusion of certain sectors, such as fishing and newspapers. Many investors, however, consider the law to be a welcome development. Some, including representatives of the Association of European Businesses in Russia (AEB), even participated in the drafting of the legislation and some of their suggestions were incorporated into the legislation. 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 will be a law defining the rules of the game.”

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165 Liuhto, Kari, *A Future Role of Foreign Firms in Russia’s Strategic Industries* 31 (April 2007).


167 C. Anne Shupe, “AEB Weighs in On Draft Investment Bill in Duma,” *Moscow News*, February 2, 2008, http://mnweekly.rian.ru/business/20080228/55312947.html (last visited April 7, 2008). “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 have seriously considered their amendment suggestions and even incorporated some of them.”

legislation will likely not have a net negative impact on FDI because there are already
limits on foreign access to strategic companies.\footnote{Thomson Financial News, “Russian Parliament Adopts Foreign Investment Law,” \textit{Forbes}, March 21, 2008, \url{http://www.forbes.com/markets/feeds/afx/2008/03/21/afx4802244.html} (last visited April 7, 2008).} 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.”\footnote{Jules Evans, “Kremlin to Clarify Rules of Game for FDI,” \textit{Russia & Eurasia Economic Digest}, (August 2007), at 17.} 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.

\textit{viii. 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 – i.e., is the law well-written? This Note will adopt criteria proposed by the Organization for Economic Co-Operation and Development (OECD) in recent policy statements regarding Russia and strategic policies. The OECD, established in 1961, is an organization “30 member countries committed to democratic government and the market economy” and is a strong proponent of FDI.\footnote{OECD, \textit{OECD Annual Report 2007} 7 (2007).} The main justification for using OECD...
criteria is that Russia wants to join that organization and therefore is mindful of its recommendations. 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, “It’s something we’ve been waiting for for 11 years.”

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. The roundtable concluded that countries should be guided by three concerns with regards 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.” Finally, the group offered several recommendations to countries implementing strategic policies. 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.”

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174 Organization for Economic Co-operation and Development, supra note 2, at 1.
175 Id., at 5.
176 Id.
OECD further commented upon the upcoming Russian legislation in 2006 in its economic policy review of Russia. Specifically, the authors concluded:

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.\(^{177}\)

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 which enterprises trigger the application of the law.\(^{178}\) Also, it spells out which characteristics of a business within those industries will raise national security concerns.\(^{179}\) Thus, the law provides a foreign investor with a descriptive guide that will allow him or her to evaluate whether or not an acquisition would require prior approval.

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178 *Federal’nyi Zakon, supra* note 1, Article 6.

179 *Id., supra* note 1, Article 10, Section 1.
Though the criteria that govern the acquisition of strategic enterprises are transparent, foreign investors will most likely be disconcerted over the procedures for obtaining approval. It is not clear what constitutes a threat to national security, much less what “gives rise” to threats to national security.\footnote{Id. In fact, the Duma Committee recommended that all the key terms in the legislation be clarified.} In some circles of the Russian government, foreign ownership itself is a threat to national security.\footnote{Gosling, supra note 31. 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.} This result is even more likely due to the fact that the very groups that lobbied for an even stricter law will now be entrusted with determining whether a national security threat exists.\footnote{Id.} 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.\footnote{Organization for Economic Co-operation and Development, supra note 2, at 5. The OECD Roundtable explicitly stated, “National security should not be used as a pretext for protectionism.”} Thus, the law could be improved if it included criteria for why a deal \textit{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.\footnote{\textit{Federal’nyi Zakon}, supra note 1, Article 10, Section 3.} Investors might justifiably be worried that the FSB will either serve the interests of a domestic patron or seek compensation for a favorable
security assessment. An improved law would explicitly define the scope, circumstances, and methods used to conduct operational-search measures, as the Committee Report recommended.

Finally, the obligations that may be imposed on investors are vague and when they may be imposed is left open to question. For example, the law provides for the obligation to take measures to prevent threats to Russia’s national security. Not only is this maddeningly vague, but it also risks being the ‘Sword of Damocles’ hanging over investors’ heads and allowing the state to dispossess them 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. 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.

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185 Sweeney, supra note 66. The TNK-BP example especially suggests how the security services can be a tool of a domestic, and specifically state-owned, competitor. At the same time, President-elect Medvedev has stated that high-level members of the government should not sit on the boards of state-owned companies (he himself is the chairman of Gazprom). Encouraging a buffer between politics and business might reduce the likelihood that the security services are used to obtain an improper advantage.

186 Komitet po Promyshlennosti, Stroitel’stvo i Nauroenkim Tekhnologiyam, supra note 132. Though the legislation has already been finalized, the President or Prime Minister could still tweak the implementation through the promulgation of formal or informal rules.

187 Federal’nyi Zakon, supra note 1, Article 12, Section 1.

188 Id.

189 Id.
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.\(^{190}\) The size of the list is even deceptive – the regulated businesses can be categorized into fifteen groups.\(^{191}\) Furthermore, most of the industries included in the list are arguably related to Russia’s national security.\(^{192}\) Nevertheless, the inclusion of certain industries – fishing, printing and publishing houses, and telecommunications companies – is puzzling.\(^{193}\)

It is also troubling that natural monopolies were included in the list of regulated industries.\(^{194}\) This effectively means that 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

\(^{190}\) *Id.*, Article 6. The vast majority of the categories – the nuclear industry, armaments and ammunition, the cryptological industry, etc. – possess a clear connection to national security.

\(^{191}\) *Id.*

\(^{192}\) *Id.*

\(^{193}\) *Id.* With regards to fishing, however, Russia did recently call for a five-year ban on sturgeon fishing in the Caspian Sea. Alex Rodriguez, “Caviar Lovers Beware: Russians May Ban Sturgeon Fishing, *The Chicago Tribune*, March 29, 2008, http://www.chicagotribune.com/news/nationworld/chic-out_there_caspianmar30,1,1630827.story (last visited April 7, 2008). “Poaching of sturgeon has become a $1 billion-a-year business largely in the hands of organized crime. As a result, the fish faces extinction in the Caspian Sea, home to 90 percent of the world's sturgeon.” Thus, Russia might, in fact, have legitimate security concerns regarding fishing.

\(^{194}\) *Id.*, Article 6, Section 36.
the other industries on the control list, in that they do not deal with weapons, defense, or state secrets.\textsuperscript{195} Furthermore, these industries are arguably the most in need of investment in Russia.\textsuperscript{196} This was recognized in the changes to the law between the first and second drafts. In the final draft, certain natural monopolies that are in great need investment – electricity and heating – were exempted from the law’s coverage.\textsuperscript{197} 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. The reason is that 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. To be precise, the strategic sectors law does not prohibit private foreign investment in any industry – it merely subjects it to prior approval in certain circumstances.\textsuperscript{198} Nonetheless, the law may in some cases have a prohibitive impact on certain, more 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

\begin{footnotes}
\item[195] \textit{Id.}, Article 6.
\item[196] See discussion above, at 23-24.
\item[197] \textit{Federal’nyi Zakon}, supra note 1, Article 6, Section 36.
\item[198] Government investors, in contrast, are prohibited from acquiring control over strategic enterprises. \textit{Federal’nyi Zakon}, supra note 1, Article 2, Section 2.
\end{footnotes}
whether this discrimination is for a legitimate purpose and whether foreign investors from one country will be treated differently than other foreign investors. The Siemens example described above certainly does not inspire confidence. Indeed, if the Federal Antimonopoly Service 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. The Russian government could, however, add a provision in the legislation prohibiting discrimination on the basis of an applicant’s home country. The fact that an investor can appeal a decision to the Supreme Arbitrazh Court could be an effective check on the Commission’s power. This will especially be the case if the Supreme Arbitrazh Court continues on its recent trend of increasing competence and independence.

d. Legislative Branch Participation Should Be Minimized

Though 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. This problem could be minimized if the Representative Body and Commission’s activities were conducted out of the public eye until their final decision. Foreign investors would

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199 OECD, supra note 2, at 5.
200 Yambaeva, supra note 78.
201 Press-Sluzhba FAS Rossii, supra note 83.
202 Federal’nyi Zakon, supra note 1, Article 11, Section 7.
203 Hendley, supra note 126, at 366.
204 Yamabaeva, supra note 78.
also probably appreciate not having their business plans in Russia broadcast for all to know.

*e. Business Secrets Might Find be Leaked*

Another troublesome aspect of the strategic sectors law is the possibility for industrial espionage on applicant investors. The law permits ‘operational search measures’ without defining their scope and duration. Thus, investors might worry that applying to acquire a strategic enterprise will open their entire company up to the Russian secret services. To some extent, foreign investors likely assume this activity occurs on a regular basis in Russia, regardless of what sector is involved. 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

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205 Organization for Economic Co-Operation and Development, *supra* note 2, 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.”

206 *Federal’nyi Zakon, supra* note 1, Article 13, Section 6.

207 Petrov, *supra* note 164.

208 Myers, *supra* note 71. The fact that, despite problems that companies like Motorola have experienced foreign investment continues to rise demonstrates a certain level of comfort with the uncertainty of doing business in Russia. Indeed, the willingness to shoulder such risks is likely due to the high return on investments in Russia.
the information within the scope of operational search measures and provided special administrative or judicial recourse to companies whose secrets have been leaked.209

**e. The Strategic Sectors Law Establishes Clear ‘Rules of the Game’**

Despite these few concerns, the strategic sectors law is supported by foreign investor groups most likely because it goes a long way in establishing clear rules of the game for foreign investors.210 Investors will generally know beforehand whether a company is considered strategic and the criteria used to determine whether a proposed acquisition must be approved by the Commission.211 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.212 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.213 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

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209 *Federal’nyi Zakon, supra* note 1, Article 13, Section 5. Currently, the law only states that damage inflicted on investors “shall be recovered according to procedures stipulated by Russian Federation legislation.”

210 *Federal’nyi Zakon, supra* note 1, 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.

211 *Id.*, Article 6 and 10.

212 *Id.*, Article 11, Section 4.

213 *Id.*, Article 2.
small. The very nature of the regulated industries would make most investors hesitate before attempting to acquire a native company.²¹⁴ If anything, the law will reduce uncertainty over these decisions and thereby increase total investment.

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. In sum, 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 foreign direct investment.

²¹⁴ Id., Article 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.