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## Property and Small-Scale Privatization in Russia.

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## PROPERTY AND SMALL-SCALE PRIVATIZATION IN RUSSIA

RICHARD C. SCHNEIDER, JR.\*

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So you imagine that you have found a fool who would sell you a registered serf for eighty kopecks? But excuse me, why do you call them registered serfs? They have been dead a long time, all that remains of them is some impalpable sound. However, not to prolong this conversation, I am prepared to go to a rouble and a half, but I can't give you more.<sup>1</sup>

### I. INTRODUCTION

*Kto vladeet chem? Chto prinadlezhit komu?* It is one of the questions most often heard in Russia today. It is asked by people about their own principal dwellings. It is asked by workers who might want

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1. NIKOLAI GOGOL, DEAD SOULS 118-19 (George Reavey trans., 1971).

to buy the factories where they work. It is asked by shopworkers who want to buy their shops. It is asked by government bureaucrats who want to be sure that they get their share. It is asked by wealthy Russians who want to seize additional opportunities. And it is asked by the hundreds of foreign businesses trying to establish themselves in the former Soviet Union. Moreover, it is now apparent that the attempt preliminarily to address the question with a union treaty in the summer of 1991 contributed to the atmosphere leading to the coup attempt in August. Who owns what? What belongs to whom?

Knowing who owns what has suddenly become important in Russia because of the dramatic economic and market reforms of the Yeltsin government.<sup>2</sup> Most of the reforms are well-known: a liberalization of prices, the introduction of profit and financial accountability, the creation of a free market in place of the command economy, and an attempt to make the ruble a freely tradeable currency. The transfer of property, especially productive property, from the state to the private sector is at the heart of the reforms. The Yeltsin government's policy of privatization has created a scramble to find out who owns what so that private sector buyers can find a profitable niche and be integrated into the new economy.

President Yeltsin has charged Anatoly Chubais, Deputy Prime Minister and Chairman of the State Property Committee (*Goskomimushchestvo* or GKI), and Dmitri Vasilyev, Deputy Chairman of the GKI, with formulating some answers to the question "who owns what" in the course of undertaking one of the largest privatization schemes ever to occur. Notwithstanding its early efforts, the Yeltsin government has come under extreme criticism, both at home and abroad, for its failure to proceed quickly enough with a full-scale privatization program.<sup>3</sup> Moreover, there is still a great deal of reluc-

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2. Recently, the Russian Congress of People's Deputies, meeting in full session in Moscow, rejected President Yeltsin's acting Prime Minister, Yegor Gaidar, and agreed upon the appointment of a new Prime Minister, Victor Chernomydrin. Serge Schmemmann, *Yeltsin Abandons His Principal Aide to Placate Rivals*, N.Y. TIMES, Dec. 15, 1992, at A1. The replacement of acting Prime Minister Gaidar, the architect of the radical economic reforms that have occurred in Russia, is viewed as a partial repudiation by the Congress of Peoples Deputies of the content and style of the Yeltsin reforms. *Id.* Notwithstanding this setback to the Yeltsin reforms, Prime Minister Chernomydrin has indicated an intent to continue the basic direction of the reforms, but with less haste and with a greater regard for the impact on the average Russian. *Id.* at A1, A7.

3. Marshall Goldman has recently criticized the Yeltsin government on these grounds. He characterizes the failure to move quickly with privatization as "a major flaw of the Yeltsin

tance to proceed with government plans to reform the system of land ownership in Russia. Some, including Marshall Goldman, are encouraged, however, that the Russian government has begun to take earnest actions to privatize certain sectors of the economy.

The first major privatization of small-scale enterprises took place during the spring and summer of 1992 in the city of Nizhny Novgorod.<sup>4</sup> About 300 such enterprises were auctioned to the highest bidders<sup>5</sup> and Nizhny Novgorod became a testing ground for the privatization program. Yegor Gaidar, President Boris Yeltsin's First Deputy Prime Minister and head of the government's economic reform plan, along with Anatoly Chubais and Dmitri Vasilyev, attended the first auction in Nizhny Novgorod. The Russian government hopes to reproduce the successful aspects of the Nizhny Novgorod experience throughout Russia, including in Moscow and St. Petersburg.

It is generally recognized that the "foundations of a market-based economic system are property rights and private ownership."<sup>6</sup> The purposes of this article are to (1) summarize the reforms that have successfully introduced a scheme of private ownership in Russia, as demonstrated by the Nizhny Novgorod experiment, and (2) discuss those property rights that remain unclear. Accordingly, the second and third parts of the article will explain how the Russians have addressed the question "who owns what" at the federal and local levels, using for this purpose the reforms in Nizhny Novgorod.

The fourth part of the article will assume that the question of own-

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reforms" and adds, "at a minimum Yeltsin should have announced his plans for privatization simultaneously with the price reform. Some critics in Russia argue it should have been announced in advance . . . [W]ithout prior or simultaneous privatization, new production was bound to be slow." Marshall I. Goldman, *Yeltsin's Reforms: Gorbachev II?*, 88 FOREIGN POL'Y 76, 83-84 (1992).

4. Nizhny Novgorod—formerly known as Gorky and the location of the internal exile of Andrei Sakharov—is a city of about 1.5 million people on the Volga River. During the Soviet years, the government had chosen to locate a number of defense-related industries there so the city was generally off-limits to foreigners. The presence of so many high technology facilities makes the city more attractive, however, from the standpoint of privatization. Also, because of its size, a widespread infrastructure of retail and food concerns provides an abundance of privatizable, small-scale enterprises.

5. According to information provided to the author by the mayor of Nizhny Novgorod, Dmitri Ivanovich Bednyakov, a total of 296 privatization transactions had occurred by September 30, 1992. More than half of these sales involved retail stores and about one-fifth involved establishments in the food industry. Interview with Dmitri Ivanovich Bednyakov, Mayor of the City of Nizhny Novgorod, in Charlotte, N.C. (Oct. 15, 1992).

6. Eduardo Borensztein & Manmohan S. Kumar, *Proposals for Privatization in Eastern Europe*, 38 IMF STAFF PAPERS 300, 300 (1991).

ership has been answered and will discuss the actual transfer of ownership from the state to the private sector. It will describe the contractual relationships between the state and the new owner of the privatized property. The Nizhny Novgorod program involving small-scale enterprises is again used as a model.

Part Five of the article will outline those problem areas that new property owners might encounter. It will discuss select issues that make the ownership transfers somewhat problematic. Is there a major inconsistency in the applicable property laws and the admittedly temporary privatization framework? What legal protections exist from government expropriation of the newly privatized property? What powers does the state retain to interfere in the use and enjoyment of the business? To what extent can the state interfere in the new owner's intended commercial use of the privatized property? Can the new owner pledge the privatized property to secure a bank loan or other credit? Finally, what rights do creditors, secured or unsecured, have against the newly privatized property?

Since the age of Aleksandr Pushkin, Russia has been a singularly literary culture. Events are framed in literature and literature may control events. It is perhaps ironic that one of the great figures of Russian literature managed to preoccupy himself with property issues in a different context. Pavel Ivanovich Chichikov, the hero of Nikolai Gogol's 1842 novel *Dead Souls*,<sup>7</sup> wanders around the Russian countryside buying the souls of dead serfs. He naturally faces the property issue of establishing clear title to the dead serfs. How meaningful is the title issue in *Dead Souls* in view of the formidably evanescent property itself?

Interestingly enough, Chichikov wants to use the property he has acquired to secure a loan from one of the Czar's government agencies. In the words of one of the foremost Gogol scholars, Chichikov had amassed a rather "ambiguous capital (consisting only of words on paper: the mortgageable lists of the dead serfs he had bought)."<sup>8</sup> How many Chichikovs are there in Russia today rushing to acquire such "ambiguous capital?" What laws protect them? These questions take on particular sensitivity because the Russian government views the

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7. Note that the year of the first privatizations in Russia is also the 150th anniversary of the publication of *Dead Souls*. Russians have been known to put great stock in such coincidences.

8. DONALD FANGER, *THE CREATION OF NIKOLAI GOGOL 181* (Cambridge 1979).

privatization program as essential groundwork to ensuring that the second Russian revolution will be irreversible.<sup>9</sup>

## II. FEDERAL REFORMS

### A. *The Property Laws*

The question "who owns what" presupposes another more basic question: "What may be owned?" Very little personal property could be owned in the Soviet Union. In fact, the concept of private property captured the essence of all that the communists considered to be wrong with capitalist societies.<sup>10</sup> Consequently, the question "who owns what" found an easy response under the old system: The state owned nearly everything and certainly anything of consequence, such as productive property. This principle had been enshrined in the Soviet Constitution itself and, a priori, in the Constitution of the Russian Federated Soviet Socialist Republic (RSFSR).<sup>11</sup>

Property relations began to change under the *perestroika* reforms of President Mikhail Gorbachev.<sup>12</sup> Many in Russia believed, however, that the changes were insufficient to overcome the economic backwardness of the country and support the newly evolving democratic

9. Note the first enumerated objective of the State Program of Privatization of State- and Municipally-Owned Enterprises of the Russian Federation for 1992: "[T]o form a group of private owners contributing to the emergence of a socially oriented market economy." *Vedomosti RSFSR* [State Program of Privatization of State and Municipality Owned Enterprises of the Russian Federation for 1992] art. 1 (June 11, 1992), reprinted in *THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 23-49* (International Finance Corp. 1992).

10. KONST. SSSR [Constitution (Fundamental Law) of the USSR] art. 13 (1977), reprinted in *8 MODERN LEGAL SYSTEMS ENCYCLOPEDIA* 8.150-152-81 (Kenneth R. Redden & Linda L. Schlueter eds., 1991) (providing for limited ownership of personal property).

11. See KONST. SSSR [Constitution (Fundamental Law) of the USSR] art. 11 (1977), reprinted in *8 MODERN LEGAL SYSTEMS ENCYCLOPEDIA* 8.150.152-81 (Kenneth R. Redden & Linda L. Schlueter eds., 1991) (providing for state ownership of the means of production, transport and communication, banking, etc.); KONST. RSFSR [Constitution (Fundamental Law) of the RSFSR] art. 11 (1978), reprinted in *Union of Soviet Socialist Republics, Supplement, The Russian Federation, in 19 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD* 3-40 (Albert P. Blaustein & Gisbert H. Flanz eds., 1991) (containing state ownership provision identical to Soviet Constitution). Article 11 of the Russian Constitution has since been amended in part to permit greater flexibility in private ownership of productive property.

12. See Larisa Krasavchikova, *Comments on the Law on Property in the Russian Soviet Federated Socialist Republic*, 24 *ST. MARY'S L.J.* 481, 481 n.3 (1992) (defining term "Perestroika"); Richard C. Schneider, Jr., *Developments in Soviet Property Law* 13 *FORDHAM INT'L L.J.* 446, 446-47 (1990) (emphasizing Gorbachev's influence in promulgating legislative reform of Soviet property laws).

reforms. While Russia was still the RSFSR, the Russian Parliament, acting under the putative shadow of the Supreme Soviet of the Soviet Union, enacted a law to begin broadening the concept of ownership in Russia. The Law on Property in the RSFSR was officially enacted on December 24, 1990.<sup>13</sup> The law provided for new property rights and deviated in dramatic respects from its Soviet correlative.<sup>14</sup>

The Law on Property, which is now unambiguously the law of Russia due to the intervening change in Russia's status from Soviet republic to independent state, provides for ownership categories based on whether the owner is a physical or legal person.<sup>15</sup> Objects that may be owned by citizens include "businesses, property complexes in the sphere of the production of goods, services, trade, other spheres of business activity, buildings, structures, equipment, means of transportation and other means of production" and "any other property of a production, consumer, social, cultural or other nature. . . ."<sup>16</sup> In a provision of broader application, "products of science . . . and other products of creative activity" can be owned by Russian citizens.<sup>17</sup> Any of these objects of ownership may be contributed to the capital of

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13. Vedomosti RSFSR [Law on Property in the RSFSR] (Dec. 24, 1990), *reprinted in* THE PARKER SCHOOL OF FOREIGN AND COMPARATIVE LAW, COLUMBIA UNIVERSITY, RUSSIA AND THE REPUBLICS—LEGAL MATERIALS (John N. Hazard & Vratislav Pechota eds., 1992). The Law on Property in the RSFSR was enacted within one year after the Law on Ownership in the USSR which was enacted by the Supreme Soviet of the USSR on March 6, 1990. Vedomosti SSSR [Law on Ownership in the USSR] (Mar. 6, 1990), *reprinted in* BASIC DOCUMENTS ON THE SOVIET LEGAL SYSTEM 269-81 (W. E. Butler ed. & trans., 2d ed. 1991).

14. *See generally* Larisa Krasavchikova, *Comments on the Law on Property in the Russian Soviet Federated Socialist Republic*, 24 ST. MARY'S L.J. 481 (1993) (detailing aspects of Russian Federation's Law on Property in the RSFSR). *See* Richard C. Schneider, Jr., *Developments in Soviet Property Law* 13 FORDHAM INT'L L.J. 446, 457-64 (1990) (discussing Soviet Union's Law on Ownership). In enacting its Law on Property, the Russian Federation simply ignored constitutional provisions which prohibited the enactment of laws contradictory to those promulgated by the Soviet Union. Larisa Krasavchikova, *Comments on the Law on Property in the Russian Soviet Federated Socialist Republic*, 24 ST. MARY'S L.J. 481, 482-83 (1993).

15. *See* Vedomosti RSFSR [Law on Property in the RSFSR] arts. 9-16 (Dec. 24, 1990), *reprinted in* THE PARKER SCHOOL OF FOREIGN AND COMPARATIVE LAW, COLUMBIA UNIVERSITY, RUSSIA AND THE REPUBLICS—LEGAL MATERIALS (John N. Hazard & Vratislav Pechota eds., 1992) (distinguishing between property rights of individuals and legal entities). The Law on Property also provides for the ownership of property by the other necessary elements of society. *See id.* arts. 17-19 (defining property rights of social organizations); *id.* arts. 20-25 (defining state and municipal property rights); *id.* arts. 26-29 (defining property rights of joint ventures, foreign citizens, organizations and governments).

16. *Id.* art. 10.

17. *Id.* art. 2, § 4.

a Russian enterprise.<sup>18</sup>

It is apparent from the text of the Law on Property that, with the possible exception of major landholdings, no significant type of personal or productive property is barred from ownership to citizens or enterprises.<sup>19</sup> With the basis for ownership thus substantially broadened from that of the old Soviet command economy, the question "who owns what" at last becomes meaningful. This is, in fact, the threshold question to any privatization program. A potential buyer of privatizable assets will not settle for anything less than unambiguous title.<sup>20</sup>

### B. *The Privatization Framework*

Notwithstanding the absence of a firm commitment under Gorbachev to privatization, the RSFSR initiated its own privatization program during the fateful summer of 1991. About six weeks before the coup attempt, the Russian Parliament adopted the Law on Privatization of State and Municipal Enterprises in the RSFSR.<sup>21</sup> The Law on Privatization structured the basic relationships between the GKI, the republic and local committees on property management,<sup>22</sup> and the various funds that would act as the sellers of state assets. It specifically required the RSFSR Council of Ministers to prepare a state privatization program to supply the details left open by the law.<sup>23</sup>

The state privatization program will be discussed in more detail in

18. *Id.* art. 14.

19. See Vedomosti RSFSR [Law on Property in the RSFSR] art. 10, §§ 1,2 (Dec. 24, 1990), reprinted in THE PARKER SCHOOL OF FOREIGN AND COMPARATIVE LAW, COLUMBIA UNIVERSITY, RUSSIA AND THE REPUBLICS—LEGAL MATERIALS (John N. Hazard & Vratislav Pechota eds., 1992) (providing for ownership of listed property without limitation).

20. ECONOMIC COMMISSION FOR EUROPE, LEGAL ASPECTS OF PRIVATIZATION IN INDUSTRY 5 (1992).

21. Vedomosti RSFSR [Law on the Privatization of State and Municipal Enterprises in the RSFSR] (July 3, 1991), reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 1-12 (International Finance Corp. 1992).

22. The governmental structure of Russia (formerly the RSFSR), requires the distinctions made in this article between the federal level and the republican and local levels. Russia is composed of autonomous republics and localities that may adopt their own legislation and interact on the federal level in ways that are similar to the federal system that exists in the United States. The idea of locality in Russia may also be somewhat unfamiliar. It includes governmental jurisdictions known as *krai*, *oblast*, autonomous *oblast*, autonomous area, and the cities of Moscow and St. Petersburg.

23. Vedomosti RSFSR [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 3, § 1 (July 3, 1991), reprinted in THE GOVERNMENT OF THE RUSSIAN FED-

the context of the Nizhny Novgorod privatization. However, the consistency between the Law on Property, as to what may be owned, and the Law on Privatization, as to what may be privatized, should be noted.<sup>24</sup> Not surprisingly, the list of objects that may be owned is somewhat broader than the list of property that may be privatized. For instance, land is not among the items of privatizable property in Article 1 of the Law on Privatization.<sup>25</sup>

### C. *The Privatization Laws*

The Law on Privatization does not attempt to answer the question of "who owns what." It more directly addresses the question of "who knows what" and sets out a framework of federal, republic, and local property funds that are to act as official sellers of privatizable assets once ownership and the right to sell have been determined. The Law on Privatization clearly vests authority in the GKI as the entity that "knows what" may be privatized and knows how privatization should be conducted. The Law additionally empowers republic and local administrations to adopt their own privatization plans<sup>26</sup> and authorizes corresponding republic and local management committees to carry out such programs.<sup>27</sup>

The responsibilities of the GKI specifically include the preparation of "proposals on delineation of State property and division thereof into property of the RSFSR, the republics comprising the RSFSR,

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ERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 1-12 (International Finance Corp. 1992).

24. Compare *Vedomosti RSFSR* [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 1 (July 3, 1991), reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 1-12 (International Finance Corp. 1992) (defining scope of Law on Privatization) with *Vedomosti RSFSR* [Law on Property in the RSFSR] art. 10 (Dec. 24, 1990), reprinted in THE PARKER SCHOOL OF FOREIGN AND COMPARATIVE LAW, COLUMBIA UNIVERSITY, RUSSIA AND THE REPUBLICS—LEGAL MATERIALS (John N. Hazard & Vratislav Pechota eds., 1992) (listing objects which may be owned by citizens).

25. *Vedomosti RSFSR* [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 1 (July 3, 1991), reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 1-12 (International Finance Corp. 1992)

26. *Vedomosti RSFSR* [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 3, § 5 (July 3, 1991), reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 1-12 (International Finance Corp. 1992).

27. *Id.* art. 5.

*krais, oblasts, autonomous oblasts, autonomous areas, and municipal property of districts, cities and other administrative and territorial entities, making part thereof.*"<sup>28</sup> Once the GKI has determined ownership, the determination itself must be ratified by the legislative body with jurisdiction over the property in question.<sup>29</sup> For example, were the GKI to determine that a specific asset belonged to a city, the relevant city council would have to ratify its ownership and a certificate would be issued to document the allocation. Decisions of the GKI are statutorily mandatory.<sup>30</sup>

The next federal step toward privatization occurred on December 27, 1991, when the Supreme Soviet of the RSFSR adopted a resolution concerning "the Division of State Property in the RSFSR into Federal Property and Property of the Republics of the RSFSR, Territories and Regions, an Autonomous Region, Autonomous Areas, the Cities of Moscow and St. Petersburg, and of Municipal Property."<sup>31</sup> The short State Property Division Resolution incorporates three addenda.

The first addendum describes federal property that belongs exclusively to Russia.<sup>32</sup> Addendum 2 lists federal property that may be transferred to a political subdivision of the federal state.<sup>33</sup> Property

28. *Id.* art. 4, § 3.

29. *Id.*

30. Vedomosti RSFSR [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 4, § 4 (July 3, 1991), reprinted in *THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 1-12* (International Finance Corp. 1992). Amendments to the Law on Privatization made in June 1992, have softened the approach to the GKI's authority by adding that only decisions within the limits of the GKI's authority are mandatory. Also, amendments providing for adjudication of disputes with the GKI by means of courts and arbitration open the door to the existence of such disputes.

31. Vedomosti RSFSR [Resolution of the Supreme Soviet of the RSFSR Concerning the Division of Property in the RSFSR] (Dec. 27, 1991), reprinted in *THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 88-92* (International Finance Corp. 1992).

32. *Id.* art. 1 & addendum 1. Such exclusive federal property includes certain natural resources and preserves of natural, historic or cultural importance, certain government property, defense-related property, and property involved in certain critical national industries, such as transportation, energy, and communications. Pharmaceuticals and the production of spirits and liquor are also categorized as industries whose property belongs exclusively to the federal government. *Id.* addendum 1.

33. *Id.* art. 1 & addendum 2. Such property includes large industries not described in Addendum 1, nuclear engineering facilities, health care facilities, research facilities, certain schools, enterprises in the building industry, and automobile manufacturing facilities. *Id.* addendum 2.

set forth in Addendum 3 is allocated specifically to the jurisdiction of the cities themselves, unless a city is affiliated with a larger district.<sup>34</sup> Property of Addendum 3 includes, most significantly, retail shops, food facilities, and consumer services.<sup>35</sup> These enterprises are the subject of the small-scale privatizations implemented in Nizhny Novgorod.

The attempts to establish possibilities for property ownership, to determine jurisdiction over property, and to liberalize the laws with respect to entrepreneurial activity,<sup>36</sup> enable the Russian government to accomplish its privatization program.<sup>37</sup> At the most simple level, privatization requires sellers and buyers. The government privatization program focuses chiefly on the sellers. It determines the nature of the property that may be privatized and the rules of sale applicable to the seller. Privatization documentation focuses on the rights and obligations of the buyer.

The Law on Privatization, the Fundamental Provisions,<sup>38</sup> and the State Program of Privatization<sup>39</sup> establish the legislative framework

34. *Id.* art. 2 & addendum 3.

35. Vedomosti RSFSR [Resolution of the Supreme Soviet of the RSFSR Concerning the Division of Property in the RSFSR] addendum 3, art. 2 (Dec. 27, 1991), reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 88-92 (International Finance Corp. 1992).

36. The Law on Enterprises and Entrepreneurial Activity of December 25, 1990 (the Law on Enterprises) was enacted in conjunction with the Law on Property in the RSFSR to prepare the legal basis for privatization. Vedomosti RSFSR [Law on Enterprises and Entrepreneurial Activity] art. 5, § 1 (Dec. 25, 1990), reprinted in THE PARKER SCHOOL OF FOREIGN AND COMPARATIVE LAW, COLUMBIA UNIVERSITY, RUSSIA AND THE REPUBLICS—LEGAL MATERIALS (John N. Hazard & Vratislav Pechota eds., 1992). The Law on Enterprises established the unequivocal right to open and run a private business. See *id.* art. 16 (defining rights of entrepreneur). It incorporated concepts familiar to legal systems outside the former Soviet bloc such as limited liability (Article 18, Section 2), exposure to creditors (Article 24, Section 3), and bankruptcy (Articles 37 and 38). See *id.* art. 18, § 2, art. 24, § 3, arts. 37, 38.

37. As stated above, the privatization program has consistently been viewed by President Yeltsin and his economic team as being the point of no return in the process of democratization. See Carroll Bogert, *Boris' Bet: Russian Roulette?*, NEWSWEEK, Nov. 11, 1991, at 38 (quoting Yeltsin as defining his economic proposals as "the most important decision of my life. . .").

38. Fundamental Provisions Concerning the Program of Privatization of State and Municipal Enterprises in the Russian Federation in 1992 (Dec. 29, 1991), reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 13-22 (International Finance Corp. 1992).

39. State Program of Privatization of State and Municipality Owned Enterprises of the Russian Federation for 1992 (June 11, 1992), reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 23-49 (International Finance Corp. 1992).

and governmental priorities applicable to privatization. Unfortunately, the legislation applicable to privatization contain no reference to the property laws discussed above. Although not necessarily a fatal flaw, such an absence certainly implies that the privatization legislation and the property laws were not overtly deemed to be *in pari materia* by the Russian Parliament.

It is not necessary for purposes of this article to develop at length the priorities applicable to the state property and assets to be privatized.<sup>40</sup> However, the privatization program itself is intended to ad-

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40. The Fundamental Provisions and the State Program divide state property into four categories: (1) property to be privatized in 1992; (2) property that may not be privatized in 1992; (3) property whose privatization requires authorization of the Russian government or of one of the local government administrations, depending on ownership; (4) property that may be privatized upon the decision of the GKI, taking into account the opinion of the relevant sectoral ministry; and (5) property subject to local privatization programs. State Program of Privatization of State and Municipality Owned Enterprises of the Russian Federation for 1992 art. 2, §§ 2.1.1 to 2.5.9 (June 11, 1992), *reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 23-49* (International Finance Corp. 1992); Fundamental Provisions Concerning the Program of Privatization of State and Municipal Enterprises in the Russian Federation in 1992 art. 1 (Dec. 29, 1991), *reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 13-22* (International Finance Corp. 1992). The first category includes enterprises involved in wholesale and retail, enterprises involved in aspects of agriculture and food processing, and enterprises that are losing money or that have major uncompleted and overdue projects. *Id.* art. 2, §§ 2.5.1 to 2.5.9. Foreign investment is, for obvious reasons, particularly encouraged in the latter two areas. The category of property that may not be privatized in 1992 includes, among other things, natural resources, historical and cultural properties, television and radio, certain defense-related industries, and infrastructure industries, such as ports, electricity, roads and pipelines. *Id.* art. 2, §§ 2.1.1 to 2.1.24; Fundamental Provisions Concerning the Program of Privatization of State and Municipal Enterprises in the Russian Federation in 1992 art. 2, § 1 (Dec. 29, 1991), *reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 13-22* (International Finance Corp. 1992). Parts of the nuclear industry, commercial banks, communications, printing, and industries involved in the extraction of raw materials make up the category of property requiring explicit authorization to privatization. State Program of Privatization of State- and Municipality-Owned Enterprises of the Russian Federation for 1992 art. 2, §§ 2.2.1 to 2.2.15 (June 11, 1992), *reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 23-49* (International Finance Corp. 1992); Fundamental Provisions Concerning the Program of Privatization of State and Municipal Enterprises in the Russian Federation in 1992 art. 2, § 2 (Dec. 29, 1991), *reprinted in THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 13-22* (International Finance Corp. 1992). The fourth category of property is comprised of large industries generally (if not treated elsewhere), industries producing tobacco, alcohol, liquor and wine products, educational facilities, and medical equipment facilities and producers. State Program of Privatization of State- and Municipality- Owned Enterprises of the Russian

dress a transitional period in Russian economic and social history. As such, the complex framework of laws, regulations, and instructions on which the framework is based is a transient stage in Russian legal reform. Once privatization has been completed, the need for the privatization framework will have passed. At that point, the property laws, and particularly the Law on Property, will be exclusively applicable to the network of new property relations created by privatization.

#### D. *The Land Decrees*

The failure to permit large-scale land privatization has been viewed by many economists and business people as a critical shortcoming of the Yeltsin reforms.<sup>41</sup> Currently, the Russian government does not contemplate that significant state land will be privatized, although individuals are permitted to own small plots and land on which a *dacha* or other small residence could be built. Nonetheless, in order to address the problem of land ownership in the privatization process, President Yeltsin signed two decrees in 1992 to authorize citizens and legal entities to own land associated with privatized assets or to enlarge a business commenced with privatized assets.<sup>42</sup>

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Federation for 1992 art. 2, §§ 2.3.1 to 2.3.13 (June 11, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 23-49 (International Finance Corp. 1992); Fundamental Provisions Concerning the Program of Privatization of State and Municipal Enterprises in the Russian Federation in 1992 art. 2, § 2 (Dec. 29, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 13-22 (International Finance Corp. 1992). Finally, local administrations have jurisdiction over certain public transport, waste-processing plants, and other services. State Program of Privatization of State and Municipality Owned Enterprises of the Russian Federation for 1992 art. 2, §§ 2.4.1 to 2.4.6 (June 11, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 23-49 (International Finance Corp. 1992); Fundamental Provisions Concerning the Program of Privatization of State and Municipal Enterprises in the Russian Federation in 1992 art. 2, § 3 (Dec. 29, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 13-22 (International Finance Corp. 1992).

41. See Marshall I. Goldman, *Yeltsin's Reforms: Gorbachev III?*, 88 FOREIGN POL'Y 76, 83 (1992) (noting delay in Yeltsin's agricultural reforms). This has left the possibility for private ownership of land unclear. *Id.* Similarly, Yeltsin is criticized for his failure to break other large monopolies. *Id.* at 78.

42. Decree of the President of the Russian Federation, No. 301 [On the Sale of Plots of Land to Citizens and Juridical Persons as Part of the Privatization of State and Municipal Enterprises] (Mar. 25, 1992) (on file with *St. Mary's Law Journal*); Decree of the President of the Russian Federation, No. 631 [On Confirming Procedure for the Sale of Tracts of Land

The Land Decrees authorize foreigners involved in the purchase of privatized assets or enterprises to acquire the appurtenant land.<sup>43</sup> The right to acquire the appurtenant land must be guaranteed to a potential buyer in a privatization.<sup>44</sup> Additional land tracts for purposes of expansion of a privatized enterprise may be acquired through “tender or auction of land unencumbered by rights of users or lessees.”<sup>45</sup> Although the Land Decrees fall short of a complete liberalization of an internal real estate market, they do mark a significant departure from the socialist concept of state-owned land and a movement toward nearly unlimited private ownership in connection with a privatization.<sup>46</sup>

### III. LOCAL REFORMS

#### A. *Federal Enabling Legislation*

The decision at the federal level to initiate a wide-reaching privatization program created the need for local implementation. The Law on Privatization, the Fundamental Provisions, and the State Program acknowledge implicitly and authorize explicitly the undertaking of

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During Privatization of State and Municipal Enterprises and the Expansion of and Additional Construction to these Enterprises, and Also Offered to Citizens and Associations of Citizens for Entrepreneurial Activity] (June 14, 1992), reprinted in *Decree Outlines Legal Procedures for Buying Commercial Land During Privatization*, RUSSIA AND COMMONWEALTH BUSINESS LAW REPORT, Aug. 10, 1992, at 3-4, 7-9 (on file with *St. Mary's Law Journal*). These provisions are collectively referred to as the Land Decrees.

43. Decree of the President of the Russian Federation, No. 631 [On Confirming Procedure for the Sale of Tracts of Land During Privatization of State and Municipal Enterprises and the Expansion of and Additional Construction to these Enterprises, and Also Offered to Citizens and Associations of Citizens for Entrepreneurial Activity] § 3 (June 14, 1992), reprinted in *Decree Outlines Legal Procedures for Buying Commercial Land During Privatization*, RUSSIA AND COMMONWEALTH BUSINESS LAW REPORT, Aug. 10, 1992, at 3-4, 7-9 (on file with *St. Mary's Law Journal*).

44. *Id.* § 6.

45. *Id.* § 12.

46. It should be noted that Section 2 of the Procedures Covering Land Sales states that “[c]ompulsory redemption of title to tracts of land sold in accordance with this Procedure is done in an amount at least as high as the cost paid by the purchaser for the tract of land.” *Id.* § 2. This unassuming sentence would seem to indicate that the Russian Government retains the unrestricted right to reclaim any land it sells so long as it reimburses (in undoubtedly devalued rubles) the amount paid by the former owner to acquire the land. President Yeltsin issued a new decree in October 1992 concerning land. Russia has embarked on a voucher system of privatization for private citizens. The decree was issued in connection with the voucher issuance to accelerate privatization. It basically permits holders of vouchers issued by the Government to exchange the vouchers for land and housing, as well as for interests in assets or enterprises being privatized.

privatization programs on the purely local level. Local privatization programs are required to be consistent with the general federal privatization framework. They must be elaborated by the local state property committee and approved by the local Council of People's Deputies (or city council, as the case may be).<sup>47</sup> Such programs may be approved for periods no longer than one year.<sup>48</sup> Local state property committees are expected to work closely with the GKI to ensure that no inconsistency develops between the permissions and restrictions on the local level and those on the federal level. Nonetheless, nothing in the Law on Privatization requires a uniform approach to the actual process of transferring property from state to private hands.

In Article 2, Section 2.4, the State Program provides partial answers to the questions: "Who owns what?" and "Who has jurisdiction to sell what property?" Article 2, Section 2.4 lists certain assets and enterprises that must be privatized on the local level.<sup>49</sup> The State Property Division Resolution provides the rest of the answers for the local state property committees. Addendum 3 to that resolution allocates specific property to local administration. The targets of the Nizhny Novgorod privatization experiment described below are specifically listed in Addendum 3: "retail shops, catering facilities and consumer services."<sup>50</sup>

The Russian government has made basic distinctions among large-, medium-, and small-scale privatizations. Different economic considerations and varying social factors are involved in each. The Russian government understands that it is much more difficult, both practically and morally, to ignore the demands of a large workforce to pre-

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47. State Program of Privatization of State and Municipality Owned Enterprises of the Russian Federation for 1992 art. 11, § 11.1 (June 11, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 23-49 (International Finance Corp. 1992)

48. *Id.* art. 11, § 11.3.

49. *Id.* art. 2, § 2.4.1 to 2.4.6. The list includes mass transit facilities, bath houses and laundries, funeral parlors, waste treatment plants, pharmacies and social, cultural and entertainment facilities. *Id.*

50. Vedomosti RSFSR [Resolution of the Supreme Soviet of the RSFSR Concerning the Division of Property in the RSFSR] addendum 3 (Dec. 27, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 88-92 (International Finance Corp. 1992). Addendum 3 also lists certain residential and non-residential building stock, certain construction and engineering enterprises, warehouse facilities and certain health care establishments. *Id.*

serve for them an equity stake in the privatization process. Consequently, large-scale privatizations involving enterprises with a workforce of over 1,000 or a book value of fixed capital in excess of 50 million rubles as of January 1, 1992, must be privatized by first being transformed from state enterprises to joint stock companies.<sup>51</sup> Such pre-privatization positioning allows the government and the GKI to earmark a portion of the shares for the workforce.<sup>52</sup> On the other hand, small-scale enterprises are to be sold at auction or through a tender process.<sup>53</sup> While not ensuring any role for the employees, auctions and tenders promise faster results. As a practical matter, then, many employees would in all likelihood be rehired by the new owner or owners.

Notwithstanding a flurry of activity among large state enterprises, their workers, and their managers, the Russian state has seen very few large-scale privatizations.<sup>54</sup> Instead, small-scale privatizations have occurred with far greater frequency on the local level. Consequently, and because a discussion of large-scale privatizations would require a separate article, the focus of this discussion is on a description of the small-scale privatizations occurring in Nizhny Novgorod pursuant to the Law on Privatization and the division of property in the State Property Division Resolution.

### B. *The Nizhny Novgorod Program*

The Nizhny Novgorod experiment in privatization, with the assistance of the International Finance Corporation, represents the most

51. State Program of Privatization of State and Municipality Owned Enterprises of the Russian Federation for 1992 art. 5, § 5.2 (June 11, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 23-49 (International Finance Corp. 1992). *See generally* Decree of the President of the Russian Federation, No. 721 [Provisions on the Commercialization of State Enterprises to be Concurrently Transformed into Open-End Joint Stock Companies] (July 1, 1992) (on file with *St. Mary's Law Journal*) (commonly known as "Conversion Decree").

52. *Id.* art. 5, § 5.4. Section 5.4 of the State Program sets out three options to provide for shareholding by the workforce in a privatizing enterprise. Workers' collectives are entitled to choose the package that suits their aims and means. Interestingly, the workforce is defined so as to include, aside from actual employees, pensioners and former employees, subject to certain restrictions, who were voluntarily discharged or discharged as a result of labor cutbacks. *Id.*

53. *Id.* art. 5, § 5.2.

54. Most of the activity so far has involved wrangling over control issues and questions regarding the eventual participation of labor and management in the capital of such enterprises.

far-reaching privatization program to date in Russia.<sup>55</sup> Nizhny Novgorod benefits from a large pool of small-scale enterprises as well as from the reformist bent of its mayor, Dmitri Ivanovich Bednyakov, and the *oblast* governor, Boris Nemtsov.

The Nizhny Novgorod program began in November 1991 when the City Council adopted two resolutions creating a city property fund and providing the broad outlines of the privatization program.<sup>56</sup> The purpose of the local legislation in the area of privatization was to ensure a stable regime for the transfer of ownership from the state to private investors. The legislation was also needed to provide some mechanism for the resolution of disputes that would inevitably arise when the ownership of the property was transferred from one group to another. The Nizhny Novgorod resolutions were expressly adopted on the basis of the Law on Privatization and the Law on Property.<sup>57</sup> The mayor of Nizhny Novgorod issued additional resolutions on March 6 and March 30, 1992. These resolutions addressed the specific legal framework for auctioning retail shops, catering facilities, and consumer services.<sup>58</sup> The City Council of Nizhny Novgorod

55. The program discussed in this article focuses on small-scale enterprises and not the major defense-related industries located in Nizhny Novgorod. The larger industries present special problems and the systematic privatization of such industries has not yet occurred. Policy justifications for beginning with the small-scale privatizations in Nizhny Novgorod include the relative lack of complexity of such transactions and the need to give more Russians a direct stake in the functioning of the economy. Also, medium- and large-scale privatizations often require foreign capital and therefore require more time and expertise to structure.

56. Nizhny Novgorod City Council, Res. No. 7/8 [Concerning the Property Fund of Nizhny Novgorod] (Nov. 14, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 111-14 (International Finance Corp. 1992); Nizhny Novgorod City Council, Res. No. 7/9 [Concerning the Program of Urgent Measures for the Privatization of Municipal Property of the City of Nizhny Novgorod] (Nov. 14, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 115-20 (International Finance Corp. 1992).

57. Nizhny Novgorod City Council, Res. No. 7/8 [Concerning the Property Fund of Nizhny Novgorod] pmb. (Nov. 14, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 111-14 (International Finance Corp. 1992); Nizhny Novgorod City Council, Res. No. 7/9 [Concerning the Program of Urgent Measures for the Privatization of Municipal Property of the City of Nizhny Novgorod] § 2 (Nov. 14, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 115-20 (International Finance Corp. 1992).

58. Both the March 6 and the March 30 Resolutions approved and had annexed to them detailed regulations on the privatization of retail shops, catering facilities and consumer services in Nizhny Novgorod. The March 30 Regulations, however, were drafted on the basis not only of the regulations promulgated on March 6 but in light of the first experiences with the

then acted by resolution on April 22, 1992, to ratify and adopt a final set of regulations concerning the privatization procedures relevant to the sale of these properties.<sup>59</sup>

The Nizhny Novgorod administration decided to apply an asset-based approach to small-scale privatizations. That is, rather than privatizing an ongoing enterprise, the city first liquidated the enterprise and then sold only the assets of the enterprise.<sup>60</sup> The Nizhny Novgorod administration reasoned, undoubtedly correctly, that potential investors would not be interested in obtaining an ongoing and perhaps heavily indebted enterprise. This asset-based approach to privatization caused an unavoidable dislocation among the workforce in Nizhny Novgorod.<sup>61</sup> For that reason, other cities looking to establish a privatization regime have not generally followed the Nizhny Novgorod model. Because other cities have not progressed so far as Nizhny Novgorod in a privatization program, however, it is not yet possible to know whether they will attain superior results in attracting investors to the local economy.

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auctions themselves. Consequently, the regulations attached to the March 30 Resolution were adopted to replace in their entirety the regulations promulgated on March 6. Head of Administration of the City of Nizhny Novgorod, Res. No. 15 [Concerning the Privatization of Retail Shops, Catering Facilities, and Consumer Services in Nizhny Novgorod in 1992] (Mar. 6, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 95-97 (International Finance Corp. 1992); Head of Administration of the City of Nizhny Novgorod, Res. No. 27 [Concerning Amendments and Additions to the Resolution of the Head of Administration of the City of Nizhny Novgorod of March 6, 1992, No. 15] (Mar. 30, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 98-102 (International Finance Corp. 1992).

59. The April 22 Resolution, building on the experience of additional auctions and the privatization procedures promulgated with the March 30 Resolution, promulgated a further set of similar regulations to regularize and ratify the actions Mayor Bednyakov had taken on his own. Presidium of the Nizhny Novgorod City Council, Res. No. 53 [Concerning the Privatization of Retail Shops, Catering Facilities, and Consumer Services in Nizhny Novgorod in 1992] (Apr. 22, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 104-10 (International Finance Corp. 1992).

60. *Id.* § 1.3. Section 1.3 of the April 22 Resolution reads “[t]he objects of privatization are the assets of liquidated municipal enterprises and their structural subdivisions of all types of trade, public catering and consumer services for the population. Municipal enterprises . . . are liquidated in accordance with the legislation of the Russian Federation and these regulations.” *Id.*

61. Mayor Bednyakov reported a resulting unemployment rate of approximately 4%. Interview with Dmitri Ivanovich Bednyakov, Mayor of the City of Nizhny Novgorod, in Charlotte, N.C. (Oct. 15, 1992).

The City Fund Resolution and the April 22 Resolution brought to the private investor the privatization regime that had begun at the federal level. Local state property management committees (a local GKI), which functioned primarily as agency decision-making bodies and as sources of information regarding privatizable assets and state property funds, had been authorized under the Law on Privatization.<sup>62</sup> Under the asset-based approach adopted by Nizhny Novgorod, the local GKI, the City Council, and the City Fund for Nizhny Novgorod collected information about a privatizable enterprise and issued a "registration certificate" or "privatization passport" for each such enterprise.<sup>63</sup> Upon issuance of a privatization passport, the relevant enterprise was placed in a liquidation proceeding pending privatization. The local GKI, upon compliance with the liquidation provisions of the April 22 Resolution,<sup>64</sup> acted as "the legal successor" of the liquidated enterprise.<sup>65</sup>

Once the local GKI was in possession of the liquidated enterprise, the assets of the enterprise had to be transferred to the local property fund for privatization. To that end, the City Fund Resolution, consistent with Article 7, Section 1 of the Law on Privatization, established the City Fund for Nizhny Novgorod and authorized it to "temporar-

62. Vedomosti RSFSR [Law on the Privatization of State and Municipal Enterprises in the RSFSR] arts. 5,7 (July 3, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 2-12 (International Finance Corp. 1992).

63. Presidium of the Nizhny Novgorod City Council, Res. No. 53 [Concerning the Privatization of Retail Shops, Catering Facilities, and Consumer Services in Nizhny Novgorod in 1992] art. 2, § 2.2 (Apr. 22, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 104-10 (International Finance Corp. 1992).

64. *Id.* art. 4. The April 22 Resolution provides that issuance of the privatization passport triggers a two-month period during which creditors of the enterprise are permitted to make claims with the local GKI. *Id.* art. 4, § 4.1. Creditors' claims are to be paid out of the proceeds of privatizations from a special account of the local GKI. *Id.* art. 4, § 4.7. At the expiration of the two-month period, the employees of the enterprise are dismissed pending sale of the assets at an auction. *Id.* art. 4, § 4.2. During this period the enterprise is managed by a liquidation committee composed of a director of the enterprise, deputies of the City Council and appointees named by the local GKI. Presidium of the Nizhny Novgorod City Council, Res. No. 53 [Concerning the Privatization of Retail Shops, Catering Facilities, and Consumer Services in Nizhny Novgorod in 1992] art. 4, § 4.3 (Apr. 22, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 104-10 (International Finance Corp. 1992). If the assets of the enterprise are for any reason not sold at the auction, the enterprise will be returned to normal operation. *Id.* art. 4, § 4.9.

65. *Id.* art. 2, § 2.4.

ily own city property certificates transferred to it by the [local GKI] for municipal enterprises, for shares in the capital of joint-stock companies, and for other city property.”<sup>66</sup> When the City Fund of Nizhny Novgorod obtained the appropriate certificate, the privatizable assets were properly positioned for sale to private investors, as required by the Law on Privatization and by the April 22 Resolution.

#### IV. SELLERS AND BUYERS

The purpose of this section is to continue to trace the devolution of the ownership of the property from the state to private investors and to describe the general nature of the new contractual relationships needed to document the transfer of ownership. Accordingly, the details of the auction process itself will not be described in this article, although there have been several regulations adopted by the GKI and the local GKI dictating the conduct and mechanics of privatization auctions.<sup>67</sup>

##### A. *Contractual Relationships*

Citizens of Russia and legal entities formed under Russian law were eligible buyers for purposes of Nizhny Novgorod’s April 22 Resolution.<sup>68</sup> However, foreign citizens as well as foreign legal entities were excluded from the Nizhny Novgorod auctions. In Russia, a legal entity is considered “foreign” for these purposes if more than twenty-five percent of its capital is held by non-Russians.<sup>69</sup> Although the policy of the Russian government and of the GKI is to encourage foreign participation in privatizations, the small-scale nature of the Nizhny Novgorod privatizations made the participation of foreigners less crucial and, from the Russian point of view, less desirable. The assets and new enterprises emerging from the Nizhny Novgorod auc-

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66. Nizhny Novgorod City Council, Res. No. 7/8 [Concerning the Property Fund of Nizhny Novgorod] art. 7, § 1 (Nov. 14, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 111-14 (International Finance Corp. 1992)

67. Such regulations include various GKI provisional regulations on auctions, conditional auctions, economic incentives and privatization committees.

68. Presidium of the Nizhny Novgorod City Council, Res. No. 53 [Concerning the Privatization of Retail Shops, Catering Facilities, and Consumer Services in Nizhny Novgorod in 1992] art. 3, § 3.2 (Apr. 22, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 104-10 (International Finance Corp. 1992).

69. *Id.* art. 3, § 3.3.

tions were meant to provide a significant basis for local initiative and employment.

Article 27, Section 1 of the Law on Privatization provides that appropriate agreements must be entered into between the seller and the buyer in a privatization transaction. After specifying the minimum terms to be included in such an agreement,<sup>70</sup> the Law on Privatization declares that "the right of property to an enterprise shall pass from the seller to the buyer from the time of registration of an agreement in accordance with the procedure determined by the legislation of the RSFSR."<sup>71</sup> Prior to its amendment in June 1992, the article went on to state that the agreement in question may provide otherwise. This additional language presumably meant that the parties may negotiate the exact timing of the transfer of title. This language could have created some uncertainty, however, if considerations other than the date and time of registration were used.<sup>72</sup> Now, after amendment, the Law on Privatization no longer states that the agreement may provide otherwise with respect to the transfer of title. Instead, the law states that a registered agreement is documentary proof of the buyer's right to ownership. This language now agrees with Article 28, Section 3 of the Law on Privatization which states that "[l]egal rights of the buyers and sellers . . . shall terminate and arise from the date of registra-

70. *Vedomosti RSFSR* [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 27, § 2 (July 3, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 2-12 (International Finance Corp. 1992).

71. *Id.* art. 27, § 3.

72. Articles 8, Sections 8.1 and 8.2 of the April 22 Resolution require registration of the privatization agreements but do not provide any detail about where or when such registration is to occur. Presidium of the Nizhny Novgorod City Council, Res. No. 53 [Concerning the Privatization of Retail Shops, Catering Facilities, and Consumer Services in Nizhny Novgorod in 1992] art. 8, §§ 8.1, 8.2 (Apr. 22, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 104-10 (International Finance Corp. 1992). Article 7, Section 7.4 of the April 22 Resolution somewhat contradicts the idea that title passes upon registration of the agreement. *Id.* art. 7, § 7.4. It provides that the right of property accrues from the moment of payment in full of the purchase price. *Id.* Article 7, Section 7.5 provides that, in the case of installment payments, the right of property accrues upon payment of 30% of the purchase price. *Id.* art. 7, § 7.5. Transfer of title upon making such payments is supported by language in the Contract of Purchase and Sale, discussed below. Contract of Purchase and Sale of Right of Ownership of Non-Residential Municipal Property, Including Equipment and Inventory, *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 140-42 (International Finance Corp. 1992).

tion of the agreement between them."<sup>73</sup>

The contractual framework put in place in Nizhny Novgorod required the buyer to sign at least four instruments or agreements to document the transfer of ownership of the privatized assets: a Record of Purchase, a Contract of Purchase and Sale, an Act of Transfer and Acceptance, and a Certificate of Ownership. Although not expressly required, presumably all four of these documents had to be appropriately registered and the full amount of the purchase price, or at least 30%, had to be paid for title in the property to pass to the buyer.

Execution of the Record of Purchase and the Contract for Purchase and Sale were required by Paragraph 9 of Addendum 1 to Nizhny Novgorod's April 22 Resolution. The Record of Purchase, a document executed immediately upon termination of the auction, attested merely to the particulars of the auction, such as identification of the assets purchased, the opening price and purchase price, the date and location of the auction, and the identity of the auctioneer.

In the Nizhny Novgorod auctions, the Contract of Purchase and Sale was signed by the seller and the buyer. This document incorporated an annex setting forth the legal description of the purchased property.<sup>74</sup> The seller was required to transfer the property to the buyer by signing the Act of Transfer and Acceptance within a specified number of days after signing the contract.<sup>75</sup> The risk of loss passed to the buyer upon the execution of the Act of Transfer and Acceptance.<sup>76</sup> Additionally, upon paying the purchase price, the

73. Vedomosti RSFSR [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 28, § 3 (July 3, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 2-12 (International Finance Corp. 1992).

74. This article looks only at the actual purchase of assets as opposed to the purchase of the right to lease assets. The purchase of the right to lease assets is documented similarly and carries with it the right to buy the assets outright during the term of the lease. Presidium of the Nizhny Novgorod City Council, Res. No. 53 [Concerning the Privatization of Retail Shops, Catering Facilities, and Consumer Services in Nizhny Novgorod in 1992] art. 7, §§ 7.7, 7.8 (Apr. 22, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 104-10 (International Finance Corp. 1992).

75. Contract of Purchase and Sale of Right of Ownership of Non-Residential Municipal Property, Including Equipment and Inventory art. 2, § 2.1.1, *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 140-42 (International Finance Corp. 1992).

76. *Id.* art. 2, § 2.1.3.

seller was issued the Certificate of Ownership evidencing title.<sup>77</sup>

The buyer in the Nizhny Novgorod auctions undertook a number of significant obligations in the Contract of Purchase and Sale. Apart from the expected payment obligations, the buyer (1) waived any claims as to the condition of the assets being sold,<sup>78</sup> (2) agreed not to sell the assets for at least one year and, if selling the assets within five years, to pay the City Fund a 30% fee on the amount realized over the total of the auction price and the cost of documented repairs and improvements,<sup>79</sup> and (3) agreed to use the premises where the assets are located for five years "exclusively for purposes of retail trade, communal services or as a shop."<sup>80</sup>

The Act of Transfer and Acceptance had a somewhat different purpose from the other documentary requirements. According to Article 4, Section 4.6 of the April 22 Resolution, to liberate the assets being privatized, the Act of Transfer and Acceptance had to be signed no later than three days after the auction by the manager of the enterprise that had been liquidated.<sup>81</sup> The buyer and the City of Nizhny Novgorod were also required to execute the Act of Transfer and Acceptance, which then had to be approved by the City Fund and the local GKI.<sup>82</sup> As described in the Contract of Purchase and Sale, the Act of Transfer and Acceptance documented the actual transfer of the assets to the buyer as well as the transfer of the risk of loss. Title to the assets was not acquired, however, until the buyer delivered the Certificate of Ownership. The Certificate of Ownership indirectly evidences receipt of the required payment of the purchase price and actual transfer of title. It is a short document that cross-references the relevant Contract of Purchase and Sale and enables the parties to refer to a fuller description of the assets themselves. One copy of the

77. *Id.* art. 2, § 2.1.2.

78. *Id.* art. 2, § 2.2.1.

79. Contract of Purchase and Sale of Right of Ownership of Non-Residential Municipal Property, Including Equipment and Inventory art. 2, § 2.2.3, *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 140-42 (International Finance Corp. 1992).

80. *Id.* art. 2, § 2.2.4.

81. Presidium of the Nizhny Novgorod City Council, Res. No. 53 [Concerning the Privatization of Retail Shops, Catering Facilities, and Consumer Services in Nizhny Novgorod in 1992] art. 4, § 4.6 (Apr. 22, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 104-10 (International Finance Corp. 1992).

82. *Id.*

Certificate of Ownership must be maintained at the tax office. Once the buyer obtained the Certificate of Ownership, the privatization process was complete.

Apart from any contractual rights the seller might have against the buyer as a result of the Nizhny Novgorod auctions,<sup>83</sup> specific justifications exist in the laws to declare one of the privatization transactions invalid. For example, a transaction may be declared invalid if the buyer was not qualified under the applicable laws and regulations; if the rules of an auction were grossly violated or illegal preferences were given to the buyer; if the transaction was not authorized by the GKI; or if illegal means of payment were used to satisfy the purchase price.<sup>84</sup>

### B. *Dispute Resolution*

An integral part of any new scheme of property relations must be an equitable dispute resolution system to safeguard the rights of parties arising out of property. The weakness of the dispute resolution system in Russian courts, arbitration proceedings, and commissions blights the sure development and enforcement of new property relations. A description of the Russian dispute resolution system is well beyond the scope of this article. Nevertheless, the specific mechanisms provided in the laws and regulations applicable to privatization should be mentioned.

The Law on Privatization itself merely refers potential claimants in an invalid privatization transaction to the courts and arbitration proceedings required or permitted by applicable legislation in Russia.<sup>85</sup> Nizhny Novgorod's April 22 Resolution provided several specific methods to resolve disputes created by the privatization effort. Two policy goals support providing more specific dispute resolution mech-

83. Article 3 of the Contract of Purchase and Sale gives the seller certain rights in cases when the buyer is not complying with the terms of the contract. Contract of Purchase and Sale of Right of Ownership of Non-Residential Municipal Property, Including Equipment and Inventory art. 3, *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 140-42 (International Finance Corp. 1992). These rights include the right to repossess the privatized property. *Id.* art. 3, § 3.1.2.

84. Vedomosti RSFSR [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 9, § 2, art. 30, § 1 (July 3, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 2-12 (International Finance Corp. 1992).

85. *Id.* art. 30, § 3.

anisms in a privatization program. First, local commissions and boards will be more knowledgeable than the courts about the privatization process itself. Additionally, the creation of special procedures may keep some disputes out of the inefficient court system but will not sacrifice a binding determination.

The April 22 Resolution of Nizhny Novgorod provided at the most practical level that any "arguments and disagreements" that occurred during the auction itself were to be resolved fully and finally by the auctioneer.<sup>86</sup> It is doubtful that such a provision could have prevented someone from lodging a claim in court relating to an auction. Still, the April 22 Resolution did attempt to deal with such "arguments and disagreements" as efficiently as possible.

Recognizing the likelihood of employee claims relating to the liquidation of enterprises whose assets were subject to privatization, the City Council of Nizhny Novgorod established a special department within the local GKI to deal with such claims.<sup>87</sup> To address the broader, more typical claims resulting from a privatization, the April 22 Resolution referred such claims to the joint deliberation of the Permanent Commission of the City Council on Economic Reform and Development of Management and Self-Management, the local GKI, and the City Fund of Nizhny Novgorod.<sup>88</sup> Again, it is doubtful that such a provision operated to deprive a persistent claimant of the right provided under the Law on Privatization to seek redress in Russian courts or through arbitration. The provisions taken together, however, represented an attempt to develop greater efficiency in the resolution of property disputes.

The foregoing description of the transfer of property from the state to private Russian investors applies, as regards the local particulars, to the situation in Nizhny Novgorod. As noted above, local administrations were given certain flexibility to structure and document their own programs under the Law on Privatization.<sup>89</sup> The Nizhny

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86. Presidium of the Nizhny Novgorod City Council, Res. No. 53 [Concerning the Privatization of Retail Shops, Catering Facilities, and Consumer Services in Nizhny Novgorod in 1992] addendum 1, § 13 (Apr. 22, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 104-10 (International Finance Corp. 1992).

87. *Id.* art. 2, § 2.5.

88. *Id.* art. 1, § 1.9.

89. State Program of Privatization of State and Municipality Owned Enterprises of the Russian Federation for 1992 art. 11, §§ 11.1 to 11.7 (June 11, 1992), *reprinted in* THE GOV-

Novgorod administration speedily elaborated a coherent privatization program. However, the costs and benefits to society and the economy of these specific reforms remain to be observed.

#### V. OPEN ISSUES: THE "DEAD SOULS" PROBLEM

The "dead souls" problem presented by the current privatization situation in Russia is two-fold. First, in the hopes that they will be able to put the assets to productive use, the new property owners accept a clear economic risk by acquiring assets. Whether the newly privatized assets are truly valuable or can be made valuable, or whether they are "ambiguous capital," however, is the essence of the market reform process. The component of economic risk entailed in the transfer of property from the state to the private sector will, in the view of President Yeltsin, make democracy a natural outgrowth of the privatization process.

The second aspect of the "dead souls" problem is more problematic. Even Chichikov had convinced himself that he could put the "impalpable sound" of his acquisitions to some productive use. Will the system, and particularly the laws, permit him to use the property in the manner in which he had intended? Will the legal system permit activities traditionally associated with private property ownership in western legal systems? Chichikov's specific aim to use the dead souls as collateral for a loan from a government agency might, in fact, very well be within the immediate purview of, for example, a buyer in one of the Nizhny Novgorod auctions. A sore need for cash exists, and using the privatized property as collateral for a loan from a bank or some other credit agency may be an immediate necessity.

##### A. *Conflicting Claims to Property*

Is the property regime implicitly assumed by the privatization framework a legal reality in Russia? The Law on Privatization and the programs and regulations that have been promulgated as a result of it are temporary. When no more property remains to be privatized,

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ERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 23-49 (International Finance Corp. 1992); Fundamental Provisions Concerning the Program of Privatization of State and Municipal Enterprises in the Russian Federation in 1992 art. 12 (Dec. 29, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 14-22 (International Finance Corp. 1992).

the legal framework for privatization will "wither away" and owners will have to look to other normative laws for their rights and protections. The Law on Property, the most important of these other laws, is buttressed by the Civil Code of the RSFSR<sup>90</sup> and must generally conform to the overarching provisions of the Constitution.<sup>91</sup>

As with so much economic and commercial legislation in Russia, the Law on Property, the Civil Code, and the Constitution have not been brought into accord. The legal deficiencies inherent in such a situation may not have been troubling when private ownership composed an insignificant part of the economy. With efforts to reverse the historical balance in the economy in full play, however, the inconsistencies in certain critical areas need to be defined.

The Constitution was adopted in April 1978 on the basis of the newly amended, so-called Brezhnev Constitution of the Union of Soviet Socialist Republics. In contradiction to what is allowed by the Law on Property, it reserves all property ownership, with the exception of certain types of non-productive, personal property, to the state.<sup>92</sup> Moreover, it flatly prohibits the productive use of personal property.<sup>93</sup> Such a reservation of state ownership was, of course, at the very heart of the socialist system and one of the reasons that the Bolsheviks quickly prohibited most private property ownership imme-

90. See GK RSFSR [Civil Code of the RSFSR] arts. 151-57 (1964), reprinted in *THE SOVIET CODES OF LAW* 391-541 (William B. Simons ed., A.K.R. Kiralfy trans., 1980) (providing for protection of property rights).

91. See KONST. RSFSR [Constitution (Fundamental Law) of the RSFSR] arts. 37-67 (1978), reprinted in *Union of Soviet Socialist Republics, Supplement, The Russian Federation*, in 19 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 3-40 (Albert P. Blaustein & Gisbert H. Flanz eds., 1991) (defining "Basic Rights, Freedoms, and Duties of Citizens of the RSFSR"); see also Draft Constitution (Fundamental Law) of the RSFSR art. 36 (1991), reprinted in *Union of Soviet Socialist Republics, Supplement 3, The Russian Federation*, in 19 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 3-77 (Albert P. Blaustein & Gisbert H. Flanz eds., 1991) (proposing "inalienable" right to own property).

92. See Larisa Krasavchikova, *Comments on the Law on Property in the Russian Soviet Federated Socialist Republic*, 24 ST. MARY'S L.J. 481, 483 (1992) (discussing expansion of personal property rights under the Law on Property in the RSFSR in comparison to Constitution of the USSR).

93. KONST. RSFSR [Constitution (Fundamental Law) of the RSFSR] art. 13 (1978), reprinted in *Union of Soviet Socialist Republics, Supplement, The Russian Federation*, in 19 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 3-40 (Albert P. Blaustein & Gisbert H. Flanz eds., 1991). Article 13 of the Constitution states, "[p]roperty owned or used by citizens shall not serve as a means of deriving unearned income or be employed to the detriment of the interests of society." *Id.*

diately after the 1917 Revolution.<sup>94</sup>

Several groups have been formulating a draft of a new constitution for Russia, but nothing has been adopted.<sup>95</sup> Notwithstanding the intent to draft a new constitution, the Constitution of 1978 still has the force of law in Russia since it has never been annulled or suspended. Indeed it was amended extensively in April 1992.<sup>96</sup> The constitutional prohibition on the productive use of property translates into a criminalization of the same activity under the Criminal Code of the RSFSR.<sup>97</sup> Additionally, the Civil Code provides that any property used in such a manner may be taken from the owner without compensation.<sup>98</sup> These glaring inconsistencies in the legislation applicable to property are not overcome by any language in the Law on Privatization or in the Law on Enterprises.<sup>99</sup>

94. W. E. BUTLER, *SOVIET LAW* 174-75 (1983).

95. See Declaration of the State Sovereignty of the RSFSR § 15 (Jul. 12, 1990), reprinted in *Union of Soviet Socialist Republics, Supplement, The Russian Federation*, in 19 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 45-47 (Albert P. Blaustein & Gisbert H. Flanz eds., 1991) (recognizing basis for elaboration of new RSFSR Constitution); see also Draft Constitution (Fundamental Law) of the RSFSR art. 36 (1991), reprinted in *Union of Soviet Socialist Republics, Supplement 3, The Russian Federation*, in 19 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 3-77 (Albert P. Blaustein & Gisbert H. Flanz eds., 1991) (proposing "inalienable" right to own property).

96. Although some might argue that the Constitution has no force in Russia, the Constitutional Court, which has already ruled on several cases and is deliberating on others, is relying on it. In fact, the act creating the Constitutional Court began with the assertion that "the supremacy of the RSFSR Constitution and its direct operation throughout the territory of the RSFSR shall be an integral element of the democratic rule-of-law state of the Russian Federation. Constitutional control shall be exercised to guarantee conformity of the provisions of legislation and the practice of their application with the Fundamental Law [the Constitution] of the RSFSR. . . ." *Vedomosti RSFSR* [Decree of the RSFSR Congress of the People's Deputies Enacting the RSFSR Constitutional Court Act] pmb. (July 12, 1992) (on file with *St. Mary's Law Journal*).

97. UK RSFSR [Criminal Code of the RSFSR] art. 153 (1960), reprinted in *THE SOVIET CODES OF LAW* 55-156 (William B. Simons ed., Harold J. Berman & James W. Spindler trans., 1980).

98. GK RSFSR [Civil Code of the RSFSR] art. 111 (1964), reprinted in *THE SOVIET CODES OF LAW* 391-541 (William B. Simons ed., A.K.R. Kiralfy trans., 1980). In response to inadequacies in its Civil Code, most of which dates from 1964, the Supreme Soviet of the Russian Federation recently adopted the USSR Fundamentals of Civil Legislation (adopted by the Supreme Soviet of the USSR on May 31, 1991). Although these provisions never became binding because of the failed coup and subsequent dissolution of the Soviet Union, Russia has adopted the provisions as a temporary solution pending the wholesale amendment of its own Civil Code. Thus, restrictive provisions such as Article 111 of the Civil Code are now arguably superseded by less "socialist" provisions.

99. *Vedomosti RSFSR* [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 2, § 1 (July 3, 1991), reprinted in *THE GOVERNMENT OF THE RUSSIAN FED-*

An additional source of concern not only for new owners but for the privatizers themselves is the fact that some state enterprises have claimed that municipal property subject to privatization actually belongs to the state enterprise and not the local GKI or City Fund. According to Mayor Bednyakov, several cases involving this claim are being arbitrated but no final decision is yet available.<sup>100</sup> The situation that has been encountered is the following: The local GKI may have decided that a grocery located in a larger, multi-purpose building will be privatized. If a state enterprise "owned" the large building pursuant to the Law on Property, the enterprise might claim that its consent is required to privatize the grocery store. More likely still, the enterprise might argue that it is owed the proceeds of privatization.

Such a state enterprise would base its claim on Article 5, Section 2 and Article 30, Section 5 of the Law on Property, arguing that the property being privatized by the local GKI belongs to it by right of "complete economic control" (*polnoe khozjastvennoe vedenije*) granted under the Law on Property. The local GKI will, of course, argue that the Law on Privatization and the State Property Division Resolution effectively remove the building from the "complete eco-

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ERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 2-12 (International Finance Corp. 1992) (allowing for governance of privatization by legislation of the RSFSR). Article 29 of the Law on Privatization provides that the state will "guarantee observance during privatization of the rights of sellers, buyers, their agents and intermediaries." *Id.* art. 29. This provision undoubtedly relates, however, to the conduct of the privatization process itself and not to the new property relations emerging from privatization.

100. Interview with Dmitri Ivanovich Bednyakov, Mayor of the City of Nizhny Novgorod, in Charlotte, N.C. (Oct. 15, 1992). This issue may become more pressing when property of the Communist Party of the Soviet Union begins to be privatized. Much will depend in this regard on the decision of the Constitutional Court of Russia concerning the constitutionality of Yeltsin's August 1991 decree nationalizing the property of the Communist Party. Communist Party property tends to be relatively quite valuable.

Another source of potentially conflicting claims to title may be claims based on pre-1917 ownership. The Law on Privatization specifically states that it "does not regulate restitution of proprietary rights of owners, successors, and heirs with respect to those enterprises that were nationalized, confiscated, or otherwise taken against the will of the initial owners. . . ." Vedomosti RSFSR [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 2, § 3 (July 3, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 2-12 (International Finance Corp. 1992). Of course, the time that has passed since the Bolshevik Revolution in comparison with the relative youth of the communist regimes in the former German Democratic Republic or Hungary reduces the likelihood of such claims arising.

conomic control” of the state enterprise by legislatively granting jurisdiction over it to the local GKI.<sup>101</sup> Whatever the legal results of such a dispute might be, the time and money spent in resolving such claims will have a negative impact on the success of the reforms.<sup>102</sup>

### B. *Property Rights*

Notwithstanding the contractual restrictions on the sale and use of privatized property mentioned above—which may not be reproduced in local privatization programs other than in Nizhny Novgorod<sup>103</sup>—the traditional activities associated with ownership would seem to be protected under existing legislation.<sup>104</sup> The problem facing a new owner under existing legislation, however, is not so much whether the practice can be envisioned, but whether old laws drafted under entirely different conditions can be adapted to the new property relations.

101. See Vedomosti RSFSR [Law on the Privatization of State and Municipal Enterprises in the RSFSR] art. 6, § 1, art. 7, § 1 (July 3, 1991), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 2-12 (International Finance Corp. 1992) (making RSFSR Property Fund sole seller of state assets to private sector).

102. According to Mayor Bednyakov, another unhappy variable in the problem is that such claims will often be referred to the state arbitration bureaucracy, which has neither the legal experience to examine such claims substantively on a case-by-case basis nor the reform-minded outlook to resist the influence of powerful state enterprises. The situation may have to be clarified through additional legislation. Interview with Dmitri Ivanovich Bednyakov, Mayor of the City of Nizhny Novgorod, in Charlotte, N.C. (Oct. 15, 1992).

103. One can question whether those contractual restrictions themselves would be enforceable in light of Article 32, Section 1 of the Law on Property. See Vedomosti RSFSR [Law on Property in the RSFSR] art. 32, § 1 (Dec. 24, 1990), *reprinted in* THE PARKER SCHOOL OF FOREIGN AND COMPARATIVE LAW, COLUMBIA UNIVERSITY, RUSSIA AND THE REPUBLICS—LEGAL MATERIALS (John N. Hazard & Vratislav Pechota eds., 1992) (providing that an act contradictory to the Law on Property may be recognized as invalid in court upon motion of injured party).

104. See *id.* art. 7. (containing provisions relating to sale of property); *id.* art. 9, § 2 (protecting right to inheritance). The Civil Code regulates certain aspects of the pledging of property, of debtor and creditor relations, and of the sale of property. GK RSFSR [Civil Code of the RSFSR] arts. 186-236 (1964), *reprinted in*, THE SOVIET CODES OF LAW 391-541 (William B. Simons ed., A.K.R. Kiralfy trans., 1980). Article 10 of the April 22 Resolution cross-references generally the “legislation of the Russian Federation” for questions both of inheritance as well as the sale of property acquired through privatization. Presidium of the Nizhny Novgorod City Council, Res. No. 53 [Concerning the Privatization of Retail Shops, Catering Facilities, and Consumer Services in Nizhny Novgorod in 1992] art. 10, § 10.4 (Apr. 22, 1992), *reprinted in* THE GOVERNMENT OF THE RUSSIAN FEDERATION, SMALL-SCALE PRIVATIZATION IN RUSSIA: THE NIZHNY NOVGOROD MODEL, ANNEXES 104-10 (International Finance Corp. 1992).

Chichikov's hopes for raising money with his dead souls provide a representative example of this kind of problem. The pledge provisions of the Civil Code, adopted when almost all property belonged to the state, never envisioned the possibility that an individual would pledge the assets of one restaurant in order to raise the cash to establish another restaurant. Russian legislators, realizing that such a problem could hinder the ability of Russian property owners to obtain credit, adopted a new law on pledging and secured transactions in May 1992.<sup>105</sup> The Law on Pledge, while untried and probably insufficient in some ways, addresses the specific issue of secured transactions in a comprehensive manner that the Russian Civil Code does not even attempt.

Finally, and perhaps most importantly, the new owner wants to be assured that his property cannot be expropriated or nationalized by the government without appropriate protections and compensation. The Law on Property is rather weak in this regard, leaving such a possibility open, although providing a statutory basis for compensation.<sup>106</sup> Article 20 of the Law on Enterprises and Entrepreneurial Activity provides additional statutory protection against an illegal taking of an enterprise's property. It also explicitly prohibits the state from interfering in the legal activities of enterprises.<sup>107</sup> Statutory protections certainly give comfort but, were the occasion of an expropriation or nationalization to arise, the owner of what formerly had been state property would have to enforce her rights in the courts or through arbitration. The weaknesses of the judicial system have already been indicated.

## VI. CONCLUSION

Nor does it seem that much cunning was required to fabricate the sledge or carriage drawn by those three horses; it was improvised with

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105. Law on Pledge of the Russian Federation, No. 2972-1 (May 29, 1992) (on file with *St. Mary's Law Journal*).

106. Vedomosti RSFSR [Law on Property in the RSFSR] art. 31 (Dec. 24, 1990), reprinted in *THE PARKER SCHOOL OF FOREIGN AND COMPARATIVE LAW, COLUMBIA UNIVERSITY, RUSSIA AND THE REPUBLICS—LEGAL MATERIALS* (John N. Hazard & Vratislav Pechota eds., 1992).

107. Vedomosti RSFSR [Law on Enterprises and Entrepreneurial Activity] art. 20, § 2 (Dec. 25, 1990), reprinted in *THE PARKER SCHOOL OF FOREIGN AND COMPARATIVE LAW, COLUMBIA UNIVERSITY, RUSSIA AND THE REPUBLICS—LEGAL MATERIALS* (John N. Hazard & Vratislav Pechota eds., 1992).

the help of an axe and a drill by some handy Jaroslavl peasant. Your driver wears no great top boots of foreign make: he is all beard and mittens, and sits perched on his seat the devil knows how; but when he stands up, cracks his whip and starts up a song, then the horses rush like a hurricane. . . .<sup>108</sup>

The Russian government has received significant foreign assistance in drafting the laws governing the privatization program. Much of the assistance has come in the form of technical aid programs from institutions such as the European Bank for Reconstruction and Development and the World Bank and International Finance Corporation. The Russians have also paid foreign advisers, such as law firms and investment banks. Notwithstanding the foreign involvement, the speed with which the laws have been prepared and the specific context within which privatization has developed, have caused some to view the privatization program as “improvised with the help of an axe and a drill by some handy Jaroslavl peasant.”

Nonetheless, the privatization program has successfully transferred a significant amount of former state property into the hands of the private sector. The Russian government has begun to expand the program into new sectors, including land auctions and the auctions of equipment used in certain heavy industries, such as trucks.<sup>109</sup> Potential restrictions on the use of property and the ability to defend title are areas of significant concern for all new property owners. The points raised in Part V above are no more than a brief adumbration of the kinds of problems that could arise.

Major pieces of the privatization puzzle—in many ways the most complicated and difficult-to-structure pieces—must yet be fit together. Still, as this article has shown, substantial progress has been made in the area of small-scale privatizations involving Russian buyers. Medium-scale and certainly the large-scale privatizations will require foreign involvement to achieve the necessary capital requirements.

In a very short period, the Russian government and the GKI have developed a rational and reasonably effective system to transfer ownership from the state to private entrepreneurs. The system appears to allocate property rights and jurisdiction in a manner that may be

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108. NIKOLAI GOGOL, *DEAD SOULS* 304-05 (George Reavey trans., 1971).

109. *Russia Auctions Some Property to Individuals*, WALL ST. J., Nov. 2, 1992, at A12, col. 4; *Truck Sale Ushers in Voucher Privatizations for Russians*, FINANCIAL TIMES, Nov. 2, 1992, at 16, col. 1.

traced, thus providing at least a minimum of certainty for buyers. Still, the inconsistencies and gaps in the current laws relating to property and the new property relations achieved through privatization must be addressed. This need will become especially acute as more and more foreigners participate in privatization transactions.<sup>110</sup>

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110. In addition, new areas must be brought into play in future medium- and large-scale privatizations. For example, the current laws and regulations on privatization do not make environmental concerns at all a part of the decision-making process. Yet, funding from multi-lateral investment and development banks such as the European Bank for Reconstruction and Development or the World Bank may require an environmental showing in order to receive funding. See Chris A. Wold & Durwood Zaelke, *Promoting Sustainable Development and Democracy in Central and Eastern Europe: The Role of the European Bank for Reconstruction & Development*, 7 AM. U. J. INT'L L. & POL'Y 559, 572 (1992) (discussing creation of "environmental veto" allowing for rejection of projects causing major environmental problems).