

## **Pamira Sainazarova, Magomed Saaduev**

*lawyers of the Kalikova & Associates Law Firm*

Opinion on [Nationalization in Kyrgyzstan](#)

Before the April 7, 2010 events, the term “nationalization” sounded somewhat archaically in Kyrgyzstan. It was mostly associated with the Soviet history lessons, classic works of Marxism-Leninism, and the revolution of 1917. But over the last year, nationalization in Kyrgyzstan became trivial. Literally, within just a few months (from May to December 2010), there have been nationalized dozens of assets, including industrial enterprises, houses, land plots, shares and interests in major companies, and other things.

Perhaps, today many people would like to know what nationalization means, what goals it is pursuing, what conditions it is subject to, and what positive and negative consequences it might have. This information can be useful to know in order to understand the ongoing processes, assuming that nationalization occurs within several days but its effects last many years if not decades to come.

### **1. What is meant by nationalization and what are its goals?**

***The term “nationalization” originates from the Latin word natio which means nation. Economic theory defines this term as transfer of private property to public ownership where the government believes that it can manage the property more effectively than the private owner. It is also said in the economic theory that nationalization is usually undertaken in respect of the property having great significance for the government and society.***

***In the legal theory, nationalization means a government policy promoting social and economic changes that enable transfer of private property to public ownership. There are many other definitions of nationalization. However, to grasp the idea of nationalization, it is important to know the reasons behind it, political and/or economic factors leading to it, purposes pursued by it in a certain country, peculiarities of historical development of the country.***

***According to many legal scientists, behind the institute of nationalization lies the idea that public interest should prevail over private interests and that the minority’s rights can be sacrificed for the benefit of the majority. But, as we all know from the Soviet Union’s history, an extreme exaggeration of the role of public interest has made this idea utopian. However, it would be fair to say that nationalization, as a phenomenon, is typical of not only socialist countries but also capitalist countries with democratic governance (below we give examples of nationalization in USA and UK). Nationalization, in the contemporary environment, means a mechanism to ensure the balance of public, social and private interests, which is, unfortunately, not always achievable. Here, it is appropriate to raise a question whether and to what extent the end justifies the means? The goals of nationalization are discussed further.***

***In the opinion of researchers studying this issue, nationalization is a political and economic mechanism of the public policy regulating economy. As the world practice shows, nationalization pursues both political and economic goals. Thus, it became quite common to use nationalization as a tool to fulfill promises given during election campaigns by politicians who gained power in the situation when the general public believes***

*that there is social injustice in the way the limited resources are distributed and such state power is necessary which is able to solve this problem.*

*Public authorities may have quite benevolent intentions behind nationalization that are far from political ambitions. Thus, nationalization might be useful to pursue in sectors where private capital might be inefficient or simply lacking and which require huge capital investments, have high degree of risks and long period of recoupment, for example, railroad transport, gas and power supply, aviation, coal or metallurgy industry. Besides, all these sectors make the core of vital strategic elements of the country's economy which is an important reason for nationalization of these sectors.*

*Historically, nationalization has been at all times triggered by wars and various conflicts so as to satisfy military needs and ensure national security of the country. Nationalization, in such cases, was necessitated by the efforts to sustain the required level of functioning of sectors (enterprise) having strategic significance for the country's defense capacity and security.*

*In the modern and contemporary history, authorities resort to nationalization in the attempt to minimize losses caused by economic crisis. In such context, nationalization can be used, in extreme situations, to establish public control over financial assets held by banks and other financial lending institutions. Thus, in 2008, in the very beginning of the US mortgage crisis which has evolved into the global financial crisis, the US authorities tried to save credit markets by nationalizing the biggest mortgage companies, but this, unfortunately, has not produced expected results.<sup>[1]</sup>*

*Nationalization has been often used by the public sector to take out of foreign control the key industries in order to preserve and maintain economic sovereignty of the country. For example, this strategy was used by Venezuela's President Hugo Chavez, who announced the nationalization of the oil industry of the country in 2007.<sup>[2]</sup>*

*However, increased public participation in property redistribution has not always been the goal of nationalization. Some countries, in particular, the UK, after the Second World War, have pursued nationalization to redistribute assets among industries so as to ensure the economic development in general to the extent that would have been difficult to achieve in the free market environment. So, the labourists, who came to power in 1945, passed the law on nationalization of the Bank of England, which became the first state-run bank in the history of the country. 1946 was marked by the nationalization of the coal industry embracing 880 companies. Later, the UK Government nationalized other strategic industries: gas sector, part of steel mills, power stations, internal transport, civil aviation, telegraph and radio.<sup>[3]</sup>*

*These are only some of the most known examples of nationalization. There are many other examples of nationalization, but all of them have one thing in common - no matter when and where it was pursued, nationalization has been always used as a tool for regulating the economy having a political connotation and drawing a wide response both within and outside a particular country.*

## **2. Regulation of nationalization by Kyrgyz law**

*What does Kyrgyz law say about nationalization? A review of the legal acts of the Kyrgyz Republic (the «KR») that regulate nationalization shows that the legal framework for nationalization is just developing:*

- *the existing regulations are definitive and only provide a general description of nationalization;*

- *there are no regulations setting forth nationalization procedures, conditions and grounds.*

*Set out below are the key legal acts that regulate nationalization and our comments thereon.*

*The Constitution of KR dated June 27, 2010*

*Pursuant to the new KR Constitution, which was adopted by referendum on June 27, 2010 (the «Constitution»),<sup>[4]</sup> the issues related to nationalization are reduced to the following: appropriation of property belonging to citizens and legal entities by the State (nationalization) is effected in accordance with law with compensation for the value of such property as well as for other losses”<sup>[5]</sup>.*

*Based on this constitutional requirement, nationalization is a form of eminent domain subject to special procedure involving the adoption of a nationalization law. For all that, a private owner is guaranteed compensation of the value of nationalized property and other damages caused by it.*

*The Civil Code of KR dated May 8, 1996*

*The first part of the KR Civil Code dated May 8, 1996 (the “CC KR”) also contains only a short legal definition of nationalization. Thus, Article 288 of the CC KR states that: “nationalization of property may occur only on the basis of a law on nationalization of this property adopted in accordance with the Constitution and with compensation to the person, whose property is being nationalized, of the value of this property and other damages inflicted by its taking”.*

*This article repeats the above constitutional provision, but specifies the nationalization procedure more definitely. This requirement excludes any possibility of nationalization other than by adopting the nationalization law in accordance with the Constitution. Also it requires that every time nationalization is held, a special law on nationalization of a given property must be adopted.*

*The KR Law “On Investments in Kyrgyz Republic” dated March 27, 2003*

*The KR Law “On Investments in Kyrgyz Republic” dated March 27, 2003 (the “Investment Law”) contains the provisions that guarantee the protection from expropriation of investments and reimbursement of investors for damages. Thus, Article 6.1 of the Investment Law states that: “no investment shall be subject to expropriation (nationalization, requisition or other similar action), i.e. forcible taking of the funds from an investor or depriving it of the opportunity to benefit from its investments, except in cases envisaged by the KR laws, when such expropriation is made for public use pursuant to non-discrimination policy and proper lawful procedure with payment of prompt, adequate and real compensation for losses including lost profit”.<sup>[6]</sup>*

*It should be explained that expropriation is a forcible alienation of property by the government with or without pay. Nationalization is one of the forms of expropriation taking the form of a forcible alienation of property with pay. Since the subject of this article is nationalization, we will analyze the above provision of the Investment Law from the point of view of nationalization.*

*Hence, according to Article 6.1 of the Investment Law, investments can be nationalized only when such nationalization is pursued in the best interests of the public. As earlier mentioned, behind the*

*institute of nationalization lies the idea that public interest should prevail over private interests, therefore, investments can be nationalized only pursuant to non-discrimination policy and proper lawful procedure with payment of compensation for losses including lost profit. For all that, non-discrimination suggests equal investment rights and their equal protection in case of nationalization, both for local and for foreign investors, regardless of their citizenship, nationality, language, sex, race, worship, place of business, and country of origin. A term “proper lawful procedure” means the investor’s right to the prompt settlement of the case if he files a claim challenging nationalization, including the judicial review or proceedings of the other competent authority (local or international arbitration) in respect of evaluation of investments and payment of compensation.<sup>[7]</sup>*

*The Investment Law requires the payment of compensation for losses inflicted by nationalization. Thus, according to these requirements, compensation must be:*

*▪ equal to objective market price of nationalized investment or part thereof (including lost profit directly as of the date of making a decision on nationalization);*

*▪ feasible;*

*▪ paid on time;*

*▪ agreed upon by the parties;*

*▪ paid in the freely convertible currency.*

*Notwithstanding the provisions that guarantee lawful nationalization (adoption of relevant nationalization law, adherence to non-discrimination policy and lawful procedure, payment of compensation for losses) there are still no mechanisms for the practical implementation of these guarantees. In the first place, for nationalization to be lawful and civilized, it is necessary that the state budget have respective financial resources to pay compensation to investors for the value of nationalized property, losses and lost profit.*

*Thus, nationalization as one of the forms of expropriation, forcible taking from the owner of his property has the following distinctive features:*

1. property owned by citizens and legal entities (private owners) passes to public ownership;
2. owner is paid compensation for the value of its property and other losses inflicted by such taking;
3. two requirements must be observed during nationalization:

- each time nationalization is undertaken, the nationalization law must be adopted in respect of the particular property;
  - this nationalization law must be adopted in accordance with the current Constitution;
4. and the most important thing is that it is the KR Jogorku Kenesh (the “Parliament”) which should decide whether to nationalize a particular property, as only the Parliament is authorized to adopt laws.

Unfortunately, we have to say that the lack of clear provisions in Kyrgyz law as to when nationalization is allowed makes nationalization a universal tool for politicians and makes investors insecure from the legal perspective, since no investor can be sure that it will not lose its property tomorrow as a result of other political changes in the country.

### **3. Nationalization in law enforcement practice of KR**

**During the period from May 20, 2010 to December 2010, the Interim Government of KR (the “IG KR”) has passed 38 nationalization decrees (the “Decrees”) pursuant to which 45 assets were nationalized.<sup>[8]</sup> According to review of the enacted Decrees their structure is as follows:**

- reference to report of the General Prosecutor’s Office and IG KR Decree dated April 7, 2010 (on transfer of state power to the IG KR);
- description of the asset to be nationalized;
- public authority or institution to which the nationalized asset is transferred (or which authority must ensure further management of the asset);
- instruction to the State Registration Office under the Government of the Kyrgyz Republic to annul the title documents (if the real estate is to be privatized);

- payment of compensation to owners less damages caused to the state (but in the most of decrees such provision is omitted);

- other provisions.

According to review of all Decrees, in general, the nationalized assets were distributed as follows 31 went to the KR Ministry of State Property, 8 went to the Executive Office of the President, 3 went to the Issykul region state administration, 1 went to the state agency for architecture and construction under the KR Government, and 2 went to the State Agency for Physical Culture and Sport under the KR Government. It should be noted that the Nationalized Assets Management Fund established specially to manage the nationalized assets<sup>[9]</sup> announced that out of 45 nationalized objects 38 will be sold at the auctions in May 2011, and the rest will remain in public ownership.<sup>[10]</sup>

There were many disputes about the legal nature of the Decrees, and they still continue, with some of them being brought before court.<sup>[11]</sup> Experts argue that the Decrees are illegal and cannot be the grounds for nationalization since they contradict the provisions of the Constitution, CC KR, Investment Law and international agreement between the KR and other countries.

Indeed, from the legal perspective, the Decrees as legal grounds for nationalization, have a disputable nature, since:

- the Decrees contradict the KR Constitution, both the former and the new one, because both constitutions require the government to pay compensation for the nationalized property and other losses inflicted by nationalization. Many Decrees even don't mention the compensation, and those which mention, provide that compensation is paid after deduction of damages caused to the government;

- the Decrees are not laws, and nationalization, pursuant to the Constitution and CC KR is allowed only on the basis of the nationalization law adopted in accordance with the Constitution;<sup>[12]</sup>

- *IG KR had no authority to take decisions on nationalization*, since nationalization can be undertaken only pursuant to law adopted by the Parliament.

## Conclusion

**History says that controversial and not always lawful transactions involving privatization of state property were the main grounds for challenging and canceling the results of privatization and subsequent nationalization of property. This happened to Severelectro OJSC, Vostokelectro OJSC, and Kyrgyztelecom OJSC which had been sold to private hands during President Bakiev's tenure. To remind, privatization of these strategic assets at unfavorable terms to the country became one of the reasons that caused the people's upheaval and led to events of April 7, 2010 and to the subsequent change in power in Kyrgyzstan.**

**For all that, in our opinion, nationalization pursued in KR in 2010 has not yet influenced the economy of Kyrgyzstan to the full extent, but it is only a question of time. Policy makers and experts having slightly recovered from revolutionary euphoria begin understanding that nationalization conducted with violation of legislation and international treaties of the Kyrgyz Republic may entail various negative consequences for**

the country. These may be litigation or arbitration cases initiated by investors against the KR Government for recovery of damages caused by nationalization (as mentioned above, there are 19 nationalization cases currently pending before the KR courts) or refusal of the current and/or potential investors to do business in our country.

Besides, it is clear today that in the future the government will face difficulties with privatization of the earlier nationalized property. Evidently, the companies with high business reputation, known as reliable business partners, viewed as potential purchasers of nationalized assets, will not be interested in purchasing the assets involving such great risks.

However, the main negative consequences and risks for Kyrgyzstan are not the possible financial losses which may arise depending on the results of litigation or arbitration processes initiated by investors or loss of potential investors who might refuse to do business in Kyrgyzstan, but the more sensible loss of reputation of the country should the court or international arbitration tribunal declare that nationalization acts and decrees of the IG KR and other public authorities of KR are illegal. Then, it is likely that damage from the broken reputation of our country will be much greater than the value of nationalized property and those ostensible benefits for which the nationalization process was initiated.

Undoubtedly, nationalization is an unalienable right of each sovereign state including Kyrgyzstan. This fact is beyond doubt and is acknowledged in the whole world. But undoubtedly, given the great influence of nationalization on the destiny of the country in general and its people, the actions of authorities in this direction must be very well thought of and weighed up. In our opinion, it is not correct to make the fateful decisions for the country being overwhelmed by emotions or desire for revenge against a negligent governor. Therefore, even if the decision is made to conduct nationalization, it should be conducted in a civilized and lawful manner and in strict compliance with the legislation of the country.

[1] In 2008, in USA, the country's biggest mortgage companies Fannie Mae and Freddie Mac were nationalized. In total, Fannie Mae and Freddie Mac held or guaranteed more than 5 trillion dollars worth of debt obligations. Thus, their bankruptcy threatened to bring down the entire financial system of the USA, in which connection it was decided to nationalize them (source: official website of RosBusinessConsulting: [www.rbc.ru](http://www.rbc.ru)).

[2] After nationalization, operative management of oil extraction, transportation and primary processing has fully passed to the state-run oil & gas corporation Petroleos de Venezuela. Among transnational oil corporations operating in Venezuela were such biggest companies as American Exxon Mobil, Chevron, Conoco Phillips, British VR, French Total, and Norwegian Statoil. All of them were ordered to sell their share of not less than 60 percent to a public company and to enter into joint ventures with it for further operation of the oil industry. According to specialists' evaluations, Hugo Chavez after completion of nationalization of the oil industry took control over 30 billion US dollars worth of projects (source: official website of the Rossiyskaya Gazeta newspaper: [www.rg.ru](http://www.rg.ru)).

[3] Source: <http://velikobritaniya.org/istoriya-velikobritanii/istoriya-anglii-v-xx-veke.html>.

[4] The Constitution of KR dated June 27, 2010, except certain sections, has taken effect on the date of official publication of results of the constitutional referendum. The results of the referendum were officially published in the Erkin Too newspaper of July 2, 2010 N 59.