

RUSSIA COUNTER-SANCTIONS EXPANSION BILL: OVERVIEW & IMPLICATIONS FOR BUSINESSES

Introduction

On Friday April 13, the Chairman of the Russian State Duma (lower house of the Parliament) Viacheslav Volodin and heads of all four State Duma factions submitted a bill "[On Measures to React \(Counteract\) to Unfriendly Activities of the United States of America and Other Foreign Countries](#)".

The bill is publicly positioned as a retaliation to the latest round of expansion of the US sanctions, introduced on April 6, and to the US CAATS Act in general. However, the retaliatory measures it suggests may be applied to much broader range of jurisdictions – virtually all countries that imposed economic sanctions on Russia since 2014 (the EU, Canada, Australia, & EU association members, EFTA members, and etc.).¹

The initiative may thus affect most of the Western corporations operating on the Russian market. The suggested retaliatory measures cover a broad range of industries (food & agriculture, pharmaceuticals, software, machinery, air transportation, commodities, etc.) and vary from banning import of goods to restricting access to public / SOEs procurement, etc. (*please see details on suggested measures below*).

However, the bill has no direct effect. It only contains a list of retaliatory measures and authorizes the President and the Government to apply them, if necessary. The President and executive branch are provided with a broad range of retaliatory options that may be applied depending on dynamics of international environment, domestic political and economic factors, etc. The political sense of the bill and thus to "institutionalize" the Russian counter-measures and create a legislative framework for retaliation to any further economic sanctions.

The status of the initiative and procedure of its implementation (the President and the Government may introduce retaliatory measures at any time and scope at their own discretion) makes it a long-term issue for multinational companies in Russia. The counter-sanctions agenda is expected to remain high-level risk for them for a long period ahead, as Russia – West political tensions continue to escalate.

¹ The bill presumes that retaliatory measures may be introduced against "any foreign country, which joined the US and introduced sectoral or personal sanctions against Russia / Russian legal entities and individuals, or supported these decisions".



Nevertheless, the level of risk the initiative poses to Western companies in Russia varies depending on the jurisdiction (country) and the economic sector:

- American corporations face higher risks compared to the companies from other jurisdictions, as the bill is driven as a response to expansion of the US sanctions.
- The companies from other jurisdictions (EU, Canada, Australia, etc.) face more limited risks, but may also fall under the restrictions in case of negative political conjuncture (Russia's tensions with respective country), or interests of influential Russian stakeholders to impose restrictions on particular company / industry.
- Domestically, the counter-sanctions agenda will be exploited by the stakeholders, both within and outside the government (state corporations, influential business groups, etc.), interested in intensifying import substitution policy, gaining access to the public procurement, or ousting concrete foreign competitor from the market. The industries, in which such domestic stakeholders exist or import substitution policy is actively implemented (e.g. foods, pharmaceuticals, software) face higher risks compared to other economic sectors.

Recommendations on dealing with the counter-sanctions risks

Despite the counter-sanctions bill is a highly-politicized topic, the Western corporations will have an opportunity to be involved in discussion, advocate their positions and influence final decisions on practical implementation of the sanctions.

The key involved stakeholders (Presidential Administration, the Government, the State Duma) now came to a consensus that the bill requires in-depth discussion with businesses and expert community, and no hasty measures able to result in negative economic implications or public resonance should be enforced.

In the State Duma, the bill will be considered under a usual procedure, which may take up to three months (till the end of July). Additional time may be required to approve bylaws enforcing concrete retaliatory measures.

This means that the companies and industries that may be affected by counter-sanctions will have at least three months to influence the discussion and minimize risks.

As previous cases of the Russian retaliatory sanctions illustrate, the Russian officials, especially in executive branch, are usually open to discuss concrete cases and make concessions on them provided two conditions: (1) well-elaborated arguments are presented by affected company (2) the issue is not considered as a national security matter. The 2014 food embargo case, when some important product categories (e.g. children food, nutritional care, lactose-free dairy products dietary supplements) were exempt from the embargo based on the arguments, presented by a broad coalition of stakeholders, confirms this approach.

However, the approach to stakeholder engagement and argumentation line should vary depending on the jurisdiction and the industry:



- The American companies facing highest risks to fall under the restrictions have more limited freedom of maneuver. They are not advised to use diplomatic (U.S. Embassy) and other inter-governmental channels to advocate their case, as this may cause adverse reaction of the Russian stakeholders. Instead, a strategy should be focused on potential allies in Russia – building a broad coalition of local stakeholders (Russian business associations, consumer associations, local customers, federal-level authorities in charge of foreign investment, regional authorities, etc.) to convey their arguments to responsible decision-makers.
- The companies from other jurisdictions, especially countries maintaining closer economic relations with Russia (Germany, Italy, France, etc.) have broader opportunities and may use the institutions of bilateral economic cooperation with Russia (inter-governmental Commissions, working groups, etc.), and even contacts at the political level. However, these channels should be used carefully not to make impression that foreign companies and governments try to influence the Russian domestic political agenda.
- The companies should be aware that although the bill is discussed by the State Duma, the Government, its Executive Office and the Ministries to be in charge of elaborating / enforcing concrete restrictions are even more important stakeholders. They should become the main targets of outreach (along with the relevant State Duma Committees).
- The opportunities to engage the Government and officials at the political level (Deputy Prime Ministers, Ministers) may be limited before the third decade of May due to upcoming Government change.² Since late May, the companies will have more options to outreach the Government officials.
- The Saint-Petersburg International Economic Forum on May 24-26 will be the first public event to be attended by the new Cabinet members and provides a workable opportunity for engagement.

Political background behind the bill

The submission of the bill to the State Duma was initiated soon after the latest round of expansion of the US sanctions on April 6 (the inclusion of Russian officials, top managers of state corporations and businessmen, as well as several companies, to OFAC's SDN list).

The bill is prepared to respond not only to the latest expansion of the US sanctions, but to the CAATS Act in general. The Russian stakeholders discussed the elaboration of the framework draft law to respond to the CAATSA since October 2017. In 2017 the retaliatory draft law was not moved forward, as the degree and toughness of CAATSA's enforcement was not yet clear by this moment.

Soon after the latest expansion of the US sanctions, which resulted in significant immediate negative impact (stock market drop, ruble devaluation, etc.), Russia's Security Council allegedly decided to move the retaliatory draft law to the State Duma.

² The current Government is to resign after the Presidential inauguration on May 7. The new composition of the Government is expected to be formed in approx. 2 weeks after the inauguration.



Please note that before this draft law was introduced, Russia already had a legislative base governing the economic sanctions. Currently, the economic sanctions are governed by the law "On Special Economic Measures". This law entitles that the sanctions may be introduced by the President and enforced the Government as temporary measures, and exact timelines of implementation should be indicated in bylaws.

To replicate the CAATSA and make the Russian retaliatory measures unlimited, the decision was made to pass a law "institutionalizing" the Russian counter-sanctions.

The political sense of the bill is thus to provide the President and executive branch with a broad range of retaliatory measures that may be applied completely, selectively or not applied at all depending on further dynamics of Russia – West relations.

List of retaliatory measures suggested by the bill

In the current wording, the bill suggests the following retaliatory measures that may be introduced by the President and the Government:

- **Food & agriculture.** The bill entitles the Government to impose ban / restrictions on import of agricultural products, commodities and foods from the US and other countries subject to restrictions (categories of products to be established by the Government).
- **Alcohol & tobacco.** Ban / restrictions on import of all categories of alcohol and tobacco products.
- **Nuclear, aircraft building and rocket engine industries.** The bill presumes halting / suspending Russia's cooperation with the US and other countries in these sectors. In case of the US, this may result in halting Rosatom's cooperation with the American companies in nuclear power industry, suspending contracts for supply of titanium to Boeing Corp. and RD-180 rocket engines to Lockheed Martin (*all these issues considered as sensitive for the US*).
- **Software.** Banning / restricting the use of software for public procurement and procurement of state-run companies. The exact list of software subject to restrictions will be established by the Government.
- **Pharmaceuticals.** Banning / restricting the import of drugs and medicaments according to the list, established by the Government, except for the drugs that have no analogues manufactured in Russia and other countries, not subject to sanctions.
- **Professional services.** Banning / restricting to provide some categories of services, including consulting, audit and legal, for public and municipal needs, as well as for some categories of legal entities (state-run companies) by entities and companies owned more than by 25% by an entity registered in the US or other country subject to sanctions.
- **Privatization.** Ban / restrictions for citizens and companies of the countries under the sanctions to participate in privatization of the Russian state property (both in acquiring the Russian state property and organizing the privatization).
- One of the most controversial provisions entitles the Russian Government **to authorize the exhaustion of exclusive rights for trademarks (brand names) of goods**



manufactured by the companies owned more than by 25% by an entity registered in the US or other country subject to sanctions. In practice, this may have two implications:

- ✓ The goods included in the list approved by the Government may be manufactured in Russia without the approval of the trademark holder.
 - ✓ For these goods, parallel import (the national principle of exhaustion of exclusive rights for trademarks) will be allowed.
- **Increasing the air navigation fees** for cargo aircrafts when using the Russian air space.
 - Restrictions on **supply of products and equipment made of rare earth metals** to the entities owned more than by 25% by a company registered in the US or other country under the sanctions.
 - **Ban to hire citizens of countries under the sanctions in Russia**, including to highly-qualified positions.
 - Restrictions or ban to import to Russia any other goods manufactured in the US and other countries under the sanctions, according to the list to be established by the Government.
 - Visa bans for citizens of countries under the sanctions, according to the list established by the Russian Foreign Ministry.

Other restrictions:

- The bill also presumes that in case of application of the national regime to Russian goods by a country under the sanctions, Russia may introduce reciprocal measures in the national regime (higher rates of taxes, other fees, etc.) with respect to goods and services from these countries.

Prospects of adoption of the bill and implementation of restrictions

On April 16, the State Duma Council scheduled the first reading of the bill on May 15. By May 3, other involved stakeholders (the Presidential Administration, the Government, committee-co-executors, etc.) may provide opinions on the bill to the responsible State Duma Committee (Committee on Economic Policy, Industry, Innovations and Entrepreneurship).

On May 3 the State Duma is planning to hold a roundtable to discuss the bill with the expert and business community. The roundtable is considered as a platform to involve a broader range of stakeholders in discussing the bill and elaborate more workable solutions.

The expected timeline of adoption of the bill is as follows:

- Once the bill passes the first reading, the State Duma is to establish 30 days period for submission of amendments to the second reading. The second reading will be held in late June at the earliest and includes voting on the amendments. The companies should plan their advocacy in the State Duma on the period before the second reading.



- The third reading is usually held in 1-2 weeks after the second one and is of formal nature (no opportunity to introduce amendments after the second reading).
- In the basic scenario, the State Duma will finally adopt the law by the end of spring parliamentary session on July 22.
- Once being adopted by the State Duma, the law will be considered by the Federation Council (upper House of the Parliament). The review by the Federation Council is usually a formal procedure. The last meeting of the Council before the summer recess is scheduled on July 24.
- In 14 days after being adopted by the Federation Council, the law shall be signed by the President and come into effect.
- The Presidential Executive Order and Decrees of the Government to enforce retaliatory measures in practice may be passed soon after the adoption of the law (*late July – August, depending on the date of adoption*).

The timeline of adoption of the law and the scope of practical retaliatory measures may also depend on dynamics of international environment:

- In case of further escalation with the US, the list of practical restrictions may be expanded.
- In case of unlikely détente in Russia – US tensions, the adoption of the law or Presidential Executive Order enforcing practical restrictions may be postponed, while the scope of retaliatory measures reduced.

Primarily, the retaliatory measures may affect the industries where Russia has a potential to substitute the import from US and other countries, as well as domestic players driving this agenda (e.g., software, pharmaceuticals, alcohol, tobacco, foods). The legally controversial measures and those able to negatively affect the Russian economy (e.g. forced exhaustion of exclusive rights for trademarks, ban for hiring American citizens, etc.) are very unlikely to be enforced.

Some measures in the industries sensitive for the US (nuclear power, aircraft building, rocket engines) may be considered as a “deterrent” against possible expansion of the US sanctions and not introduced as well.