

U.S. Sanctions Relief: Good for Russian Companies but Bad for Policy?

By Richard Nephew
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Overview

Congress is considering now whether to block the Treasury Department's decision to remove sanctions on three companies designated due to their ownership by Oleg Deripaska, a U.S.-sanctioned Russian oligarch. This decision is important not only because of the effect these sanctions have had on global metals markets but also for the future of U.S. sanctions policy and enforcement related to Russia. The agreement reached to provide sanctions relief to these companies is mostly technically sound, but the underlying policy and the Trump Administration's commitment to enforcing U.S. sanctions law against Russia is significantly more questionable. Congress should utilize the powers of its oversight to ensure answers to its questions both on the scope of the agreement and its limitations, and the Trump Administration's future posture vis-à-vis Russia and its oligarchs.

Background

On 19 December 2018, the Treasury Department announced that it would remove sanctions against three Russian firms – EN+ Group, United Company RUSAL, and JSC EuroSibEnergo (ESE) – pursuant to a negotiated agreement with those companies. In so doing, the Treasury Department was attempting to resolve a problem created by its designation of those companies on 6 April 2018, and [global metals markets soared due to the threat to the world's second-largest aluminum supplier](#). These sanctions were imposed against the companies by virtue of their ownership by Oleg Deripaska, a key Russian businessperson identified by the U.S. government as an oligarch. There are no proposals to remove sanctions against Deripaska at this time.

To support this decision, the Treasury Department released an [eight-page memorandum](#) to Senate Majority Leader Mitch McConnell, detailing the terms of an agreement reached between those companies and the Treasury Department. The memorandum is comprehensive and detailed, identifying how Treasury will guard against malfeasance from those companies and corruption of the arrangement. The memorandum and the process that led to its drafting has been saluted as good sanctions practice, an example of how to use the tool properly.

In many respects, this is a fair and justified assessment. However, “good sanctions practice” has more than one angle to it. To utilize sanctions properly, one needs to do more than apply them with care and remove them with vigilance. Sanctions also need to be assessed in their overall context, including with an assessment as to the viability of the enforcement provisions if future cheating is detected. Moreover, “good sanctions practice” requires consideration of the decision in the scope of an overall policy and, here, there are far more questions than answers.



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This paper assesses the good and bad points of the agreement reached by Treasury with EN+ and other petitioning companies, and suggests some next steps.

Strengths of the agreement

The Treasury Department's written explanation of its agreement with EN+ does have many strong points, demonstrating the continued professionalism and vigilance of the Office of Foreign Assets Control (OFAC). It is evident that the OFAC did not accept the first offer that was made to it by EN+ and other petitioners but, instead, spent a significant amount of time evaluating proposals and considering the best outcome for the United States.

Three key points stand out.

First and foremost, Deripaska will be forced to relinquish his ownership stake in EN+, going from a 70 percent share of the company to 44.95 percent. At a fundamental level, this would allow EN+ to be removed from U.S. sanctions, as the basis for its inclusion on the 6 April 2018 slate of sanctions was that Deripaska owned it.

Of course, OFAC is not ignorant of the many ways in which minority shareholders can control companies, particularly in the Russia context. In 2014, the United States clarified that, in certain circumstances, it could consider minority owners as the controllers of designated Russian entities, and it has long been a principle that ownership or control were justifications for sanctions decisions.

To address this problem, Treasury demanded a second, key element for an agreement: an extensive process that denies Deripaska the ability to exercise control over the company at its top, corporate level. The Board of Directors is to be replaced and its future constitution will be subject to a process engineered to offer independence from Deripaska. Various reviews and audits will be conducted to ensure that this remains the case. Arguably, there may yet be ways for him to steer the company – he will still be able to vote 35 percent of EN+ shares, and he was sanctioned in part for willingness to bribe and coerce other businessmen -- but Treasury has also identified ways to deal with this problem, including by demanding independent voting of the remaining shares. The oversight arrangements accepted by OFAC and EN+ are fairly extensive and verifiable, requiring – as Treasury has noted – unprecedented transparency into the company.

The third strong point is that Treasury has underscored its ability and readiness to reimpose sanctions on “any or all of these companies should the change in circumstances represented by their implementation of the agreement with OFAC be reversed, including by a material breach of the terms of the agreement.” With this threat in place – and, presumably, with the added risk that OFAC once betrayed would be far less forgiving in future negotiations – Treasury has created a sense of immediate risk and consequence for any breach of the terms. Arguably, this will create real pressure on EN+ and others party to this agreement to keep to the terms.

Weaknesses or open questions

Herein lies the critical area in assessing the agreement reached between OFAC and EN+, the degree to which a future Treasury decision to relist EN+ is seen as credible. On the one hand, Treasury's imposition of sanctions in the first place ought to suggest that Treasury would be prepared to act swiftly in the event of breaches. On the other hand, however, this commitment is dubious on several grounds.

Treasury's frequent delays over the implementation of sanctions against EN+ et al. betrays a real reluctance to face the consequences of those sanctions. Notwithstanding having announced the sanctions package on 6 April, the measures themselves have never been live because of continued extension of a general license that delayed implementation for nearly nine months. Treasury did this because of ongoing negotiations, but also because the action created widespread panic in international markets. As OFAC notes itself in the memorandum "the designation of RUSAL, the world's second-largest aluminum producer, was felt immediately in global aluminum markets. The price of aluminum soared in the weeks following the designation, and RUSAL subsidiaries in the United States, Ireland, Sweden, Jamaica, Guinea, and elsewhere faced imminent closure without limited sanctions mitigation in the form of OFAC general licenses." These repercussions also suggest Treasury senior leadership had not appropriately considered the implications of their decision, a demonstration of flawed sanctions policymaking and apparently notwithstanding [staff-level attempts to explain the risks](#). Such a decision also raises the risk – or that the perception -- that Treasury will flinch if faced with the need to reimpose these sanctions in the future.

It should be noted that the Trump Administration has hardly been the poster child for aggressive Russia sanctions enforcement. Certainly, as OFAC notes, there have been designations of Russian individuals and entities during this Administration. Enforcement of those sanctions, however, has been limited and targeted to an almost minute degree, focusing on Russian intelligence officers and front companies rather than economic assets or other oligarchs. Even the 6 April decision came about only after months of criticism of the Trump Administration's failure to meet deadlines for sanctions enforcement and the threat of new legislation in early 2018. A congressional hearing backed Secretary Steve Mnuchin [into sanctioning Deripaska](#) in a congressional hearing -- he did not seek out this opportunity to act, as is demonstrated by the absence of any similar sanctions against Russian oligarchs after 6 April. Congress and others can, therefore, be excused for expressing real skepticism over the terms of the OFAC agreement, not least because it was released after months of work on 19 December. Legislators were on holiday break for much of legislatively-mandated 30-day review period.

More questions must be answered before we can truly assess the scope of the relief being granted. In addition to those put forward by [Senator Robert Menendez](#), there are three more that stand out:

1. The agreement says that Deripaska's shares will be, in part, acquired by VTB Bank in exchange for relieving him of debts he has outstanding to VTB. How many shares and how much debt is to be relieved? The agreement says that no part of the transactions associated with Deripaska's removal can put cash into his hands. VTB's relief of substantial debt could be effectively the same thing, however.

2. VTB's involvement itself is problematic, as it is itself subject to U.S. sanctions (though, as Treasury points out in its memorandum, those sanctions would not cover this transaction per se) and, more importantly, has engaged in opaque business transactions in the past. For example, Reuters [reported in November](#) that VTB offered loans to help facilitate a dubious privatization effort for Rosneft. VTB's involvement in this transaction is therefore not reassuring as a sign of independence or transparency.
3. Which institution will hold the blocked account into which Deripaska's dividends and any other proceeds are to be transferred? VTB? Another bank? The institution chosen is important.

More fundamentally, the agreement itself – and the underlying negotiations which led to it – operates on a different set of assumptions about the purpose of U.S. sanctions policy against Russia, EN+, and Deripaska himself. The agreement states that “the objectives of the sanctions were to reduce Deripaska’s ownership in and sever his control of these entities.” That may be, with respect to EN+, RUSAL, and ESE. It is absolutely not the purpose of the sanctions program against Russia, however. As Treasury notes, these sanctions “are designed to change behavior” -- the behavior of the oligarchs, of President Putin, and the Russian government more generally.

The sanctions removal decision does damage to that objective, undermining Treasury’s contention that this action does not “significantly alter U.S. foreign policy.” By removing the sanctions, Deripaska is himself damaged to some degree. The extent of that damage has yet to be demonstrated, however, and – as noted by Senator Menendez – Deripaska may be compensated by the Russian government for his travails. He has been [bailed out before](#), and the Russian government is still [clearly in his corner](#). U.S. policy toward Russia is about applying pressure on the Russian government. Removing the sanctions on EN+ will benefit the Russian government, for which the export of metals is a key revenue generator. Likewise, the financial impact of the sanctions on Russian markets, in general, was severe in April 2018. Their removal will help buttress the Russian economy, especially if it supports the perception that similar sanctions will not be imposed.

What should happen

For these reasons, Congress should take a good, hard look at the decision to remove these sanctions. Congress should push the Administration to answer two sets of questions, the first dealing with the unresolved questions around the removal proposal and the second with the overarching Russia policy. Secretary Mnuchin has reportedly met with House Committee Chairs (though press reports suggest it did not go well) and should do the same with Senate Committee Chairs and Ranking Members to explain what happened and to provide further details on the OFAC agreement. If the Treasury Department is not forthcoming in its answers or if those answers do not provide sufficient comfort as to the nature of both the agreement and the U.S. government’s commitment to hold EN+ to it, then Congress should consider and debate a resolution of disapproval under the terms of the 2017 Combating America’s Adversaries Through Sanctions Act (CAATSA). If rejected by Congress, the Treasury Department ought to have sufficient leverage remaining with EN+ to reopen negotiations to address reasonable concerns raised by Members. Unlike with other agreements (especially those involving multiple states like the JCPOA), the United States is holding most of the cards in this negotiation.

More importantly, this ought to be the moment in which the Executive Branch and Congress meet to consider and discuss our Russia sanctions policy going forward. There remain a number of outstanding issues, not least that the State Department has yet to announce the sanctions to be imposed against Russia for its attempted assassination of Sergei Skripal via chemical weapons. Moreover, we also await answers on how the Trump Administration will enforce sanctions on Russian arms exports and what will come next in the greater economic sanctions campaign. Events in the Kerch Strait underscore that this is not a time for timidity or mixed signals in confronting the Russians. If the Trump Administration can deliver meaningful and robust commitments on continued economic pressure – including using similar sanctions approaches with other Russian oligarchs, if they’re convinced the EN+ case is a sterling success – then the Congress should allow them to do so, exercising oversight. If, as is more likely, the Trump Administration declines such an opportunity, then Congress should use this moment to develop and pass new legislation that would ensure that the U.S. sanctions posture towards Russia remains firm and unambiguous until the many, longstanding concerns with Russian behavior are satisfied.

After all, good sanctions practice is not merely about relieving sanctions when the legal terms for their removal are satisfied. It is also ensuring that the consequences of sanctions pressure are felt directly and effectively by their targets, relieving pressure only in exchange for verifiable, sturdy, and effective resolutions of the underlying problems.

About the Author

Richard Nephew joined the Center on Global Energy Policy as a Senior Research Fellow in February 2015, having previously worked as Principal Deputy Coordinator for Sanctions Policy at the Department of State, a position he held since February 2013. Nephew also served as the lead sanctions expert for the U.S. team negotiating with Iran. From May 2011 to January 2013, Nephew served as the Director for Iran on the National Security Staff where he was responsible for managing a period of intense expansion of U.S. sanctions on Iran.

The views in this commentary represent those of the author.

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