Russia Political Economy Project

Anatomy of a Muddle:
U.S. Sanctions against Rusal and Oleg Deripaska

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Foreign Policy Research Institute

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About the author

William R. Spiegelberger was the Director of the International Practice Department at Rusal (Moscow) until April 6, 2018 when U.S. sanctions were imposed on the company and two of its main shareholders. Spiegelberger was 2015-18 board member of Strabag SE (Vienna); member, National Advisory Council, Harriman Institute. He received his J.D. from Columbia University and is the author of The Enforcement of Foreign Arbitral Awards in Russia.

Executive Summary

William R. Spiegelberger

The purpose of The Countering America's Adversaries Through Sanctions Act of 2017 (CAATSA) is to encourage Russia to desist from "future influence efforts worldwide, including against U.S. allies and their election processes" by imposing pain on the decision makers in the Kremlin. In April 2018, the U.S. Treasury Department imposed sanctions under CAATSA on United Company Rusal and Oleg Deripaska. In January 2019, the sanctions were withdrawn against Rusal after U.S. allies complained that destruction of the company would injure their interests. The sanctions against Deripaska remained in effect. This outcome does not serve CAATSA's purpose. Individuals are replaceable and unlikely to ever be convinced to break ranks with the Kremlin. On the contrary, sanctions against individuals are more likely to force them further into the hands of the Kremlin or even cause their businesses to be nationalized. Only damage to a major Russian industrial enterprise would cause the pain necessary to dissuade the Kremlin from mischief abroad. Any collateral damage to U.S. partners and allies could be avoided in most cases by announcing that sanctions will be imposed on a given Russian enterprise only after a grace period sufficient to give the non-Russian counterparties of the enterprise time to find alternative supplies and to allow the relevant market to rebalance.

Introduction

On Monday, April 9, 2018, Russian aluminum producer United Company Rusal lost half its market value. In quick succession thereafter, the company announced that it may be in technical default on its loans, and four Rusal board members resigned, including Ivan Glasenberg, CEO of the Swiss commodities giant Glencore, and Philip Lader, former U.S. ambassador to the United Kingdom. Rusal instructed customers to cease making payments to the company lest their dollar transfers be stopped and seized. Several large buyers then announced they would stop purchasing Rusal aluminum. Within a week, the ruble slumped 10% against the dollar, and the price of aluminum spiked 15%. The cause of this crisis: U.S. sanctions imposed on Friday, April 6, 2018, against Rusal and two of its ultimate beneficial owners, Oleg Deripaska and Viktor Vekselberg.

Within days, Rusal was granted a stay of execution. Apparently in response to complaints from U.S. "partners and allies," the U.S. Treasury Department began issuing licenses that granted Rusal's counterparties more time to disengage from the company. It was these complaints, as well as ostensible solicitude for the "hardworking people who depend on Rusal," that ultimately moved the Treasury Department to lift the sanctions against Rusal in early 2019 in exchange for Deripaska's agreement to reduce his stake in the company.

Opinions are divided on this outcome. Ambassador Daniel Fried, former Assistant Secretary of State for European and Eurasian Affairs, believes, "This deal makes sense on the merits."[1] In contrast, Aleksey Navalny, the perennial Russian opposition candidate, described the lifting of sanctions on Rusal as a "huge mistake" and called U.S. sanctions policy toward Russia "a chaotic, incomprehensible mess." Sanctions, Navalny says, should be imposed on wealthy, Kremlin-connected "political oligarchs."[2]

This report comes closer to Navalny than Fried in its conclusions. The erratic trajectory of events—from the enactment of the relevant U.S. sanctions law, through the imposition of sanctions on Rusal, to the ultimate lifting of those sanctions in a structured settlement—cannot be explained except as a muddle that will not exert the effect on the Kremlin that Congress intended. That muddle is examined here, and a different approach is proposed for imposing effective sanctions in the future.

1 Richard Levick, "Rusal Sanctions Policy: A Model for 'Muscular Corporate Governance,'" *Forbes*, Feb. 7, 2019, at https://www.forbes.com/sites/richardlevick/2019/02/07/rusal-sanctions-policy-a model-for-muscular-corporate-governance/#30f847849dbd.

2 Max Seddon, "'Chaotic' sanctions against Russia have failed, says Navalny," *FT*, Feb. 27, 2019, at https://www.ft.com/content/e0374338-36c8-11e9-bd3a-8b2a211d90d5.

CAATSA Contra Kremlin

Secretary of Treasury Steve Mnuchin.

The April 6 sanctions arose out of a bill that President Donald Trump reluctantly signed into law on August 2, 2017.[3] That law, "The Countering America's Adversaries Through Sanctions Act" (CAATSA), provides a framework for imposing sanctions on Iran, North Korea, and Russia. Title II of CAATSA, entitled "The Countering Russian Influence in Europe and Asia Act of 2017," quotes a January 2017 assessment of the U.S. intelligence community that

> *Russian President Putin ordered an influence campaign in 2016 aimed at the United States presidential election. . . . Moscow will apply lessons learned from its Putin-ordered campaign … to future influence efforts worldwide, including against U.S. allies and their election processes.*

CAATSA was Congress' way of encouraging the Russian president—or, more precisely, of encouraging the U.S. president to encourage the Russian president—to desist from such efforts.

CAATSA does not, however, provide for sanctions against Putin himself. It employs an indirect, two-stage approach: first *threaten* a large number of Russian political and business figures with sanctions, then *sanction* a subset of these figures when and how the executive branch later decides. Accordingly, CAATSA required the Secretary of the Treasury, in consultation with the Director of National Intelligence and the Secretary of State, to prepare within 180 days of CAATSA's enactment a report identifying the most significant "senior" and "other political figures" in Russia, as well as Russian "oligarchs … as determined by their closeness to the Russian regime and their net worth." The report duly appeared on January 29, 2018, and contained the names of 114 political figures and 96 "oligarchs."[4] As Secretary Steven Mnuchin said at the time, "The intent was not to have sanctions by the delivery of the report last night. The intent was to do an extremely thorough analysis – it's hundreds of pages – and there will be sanctions that come out of this report."[5] What the Treasury Department had not yet determined was the kind of sanctions to be imposed.

3 President Trump released a signing statement in which he said that the bill "encroaches on Executive power, disadvantages American companies, and hurts the interests of our European allies." Statement by President Donald J. Trump on Signing the "Countering America's Adversaries Through Sanctions Act," Aug. 2, 2017, at https://www.whitehouse.gov/briefings-statements/statement-president-donald-j-trump-signing-countering-americas-adversaries-sanctions-act/.

4 The full name of the report is "Report to Congress Pursuant to Section 241 of the Countering America's Adversaries through Sanctions Act of 2017 Regarding Senior Foreign Political Figures and Oligarchs in the Russian Federation and Russian Parastatal Entities." The report is a publicly available document, but there is also a classified annex to the report.

5 "Trump Administration Defends Decision Not to Immediately Impose New Russia Sanctions," VOA, Jan. 30, 2018, at https://www.voanews.com/a/russia-putin-us-kremlin-insiders-oligarchs-list/4231283.html.

From Yawn to Crisis

Russia greeted the January report with derision and relief. Its list of oligarchs seemed to have been drawn from the *Forbes* 2017 list of the World's Billionaires.[6] This gave the impression that the Treasury Department had not, in fact, done "an extremely thorough analysis" as Mnuchin claimed, but merely went through the motions of complying with the law. And since the report itself did not impose sanctions but required the executive branch to take further action, many in Russia believed that the U.S. president, who had been named an "honorary Russian Cossack" in late 2016 for his obliging stance toward Putin,[7] would likely temper Congress' zeal to punish Russia. The honorary Cossack had, after all, called CAATSA "seriously flawed" when he signed it into law.[8]

Putin joked that he felt "slighted" that his name was not on the list.[9] Of course, his sarcasm may have masked genuine concern, but certain hard facts suggest that the threat of sanctions was not taken seriously in Russia or on the relevant markets: neither the enactment of CAATSA nor issuance of the report had a discernible effect on the share price of Rusal, a high-probability target of sanctions. Rusal shares traded at about HK$4.4 just before CAATSA was enacted on August 2, 2017, and at about HK$5.9, some 34% higher, in the days after report came out on January 29, 2018. The aluminum market was also unaffected.

The bomb hit on Friday, April 6, 2018, when Deripaska, Vekselberg, and Rusal, as well as two of Rusal's corporate parents, EN+ (primarily owned by Deripaska) and Sual Partners (primarily owned by Vekselberg and another Soviet-born businessman, Leonard Blavatnik)[10] were, among others, named as a "specially designated nationals" or SDNs. SDN status can be a big a problem. U.S. citizens and entities cannot do business with an SDN or with entities in which one or more SDNs in aggregate hold a 50% or greater stake under the Treasury Department's "50 Percent Rule." A subdivision of the Treasury Department, the Office of Foreign Asset Control (OFAC), publishes a list of SDNs. U.S. banks, through which the vast majority of international dollar transfers must pass, check all such transfers against the list and impound those to or from an SDN. All of an SDN's dollar accounts and assets in the U.S. are also to be arrested. SDN status essentially turns the targeted individual into an untouchable, at least with regard to dollars, U.S. banks, and U.S. persons. The result for Rusal, which, like other producers, sells aluminum primarily for dollars, was devastating: the company was brought to its knees over a quiet weekend in April.

With Rusal under pressure from sanctions and

6 See, Leonid Bershidsky, "The U.S. List of Russian Oligarchs Is a Disgrace," *Bloomberg*, Jan. 30, 2018, at https://www.bloomberg.com/opinion/articles/2018-01-30/the-us-list-of-russian-oligarchs-is-a-disgrace.

7 See, "Trump Named Honorary Russian Cossack," *Moscow Times*, Nov. 10, 2016, at https://www.themoscowtimes.com/2016/11/10/trump-named-honorary-russian-cossack-a56070. The honor was later revoked. See, "Russian Cossacks Strip Trump of 'Honorary Cossack' Status Amid Syria Threats," Moscow Times, Apr. 11, 2018, at https://www.themoscowtimes.com/2018/04/11/russian-cossacks-strip-trump-honorary-cossack-status-amid-syria-threats-a61131.

8 See, Statement of President Trump, supra note 3.

9 See, Andrew Roth & Carol Morello, "Kremlin reacts with anger and ridicule to Treasury list of influential Russians," *Washington Post*, Jan. 30, 2018, at https://www.washington post.com/world/kremlin-reacts-with-anger-and-ridicule-to-treasury-list-of-influential-russians/2018/01/30/f5405586-05c7-11e8-8777-2a59f168dd2_story_html?utm_term=.4e0ce5db8405.

10 Born in Soviet Ukraine, Sir Leonard Blavatnik became wealthy through his various businesses in post-Soviet Russia. He has since taken up residence in the UK, where he is widely considered the country's richest man with a reported net worth of about $20 billion. His company, Access Industries, is one of the main owners of Sual Partners, which holds 26.5% of Rusal, the other being the Renova Group, owned by Vekeselberg.

the aluminum market roiled, what followed was a confusing series of statements and events that suggest the Treasury Department had engaged in a bit of "what does this button do?" sanctions policy and quickly regretted the consequences. April would be a busy month. On Sunday, April 15, nine days after Rusal was sanctioned, then-UN Ambassador Nikki Haley said on *Face the Nation* that the U.S. would be imposing further, unspecified Russian sanctions on Monday, April 16. National Economic Council Director Larry Kudlow then promptly contradicted her, remarking that Haley had suffered "momentary confusion,"[11] a charge she strenuously denied. In the meantime, U.S. allies and aluminum consumers expressed concern about the dire effect that the Rusal sanctions could have on their businesses, since Rusal produced about 6% of the world aluminum supply in 2017 (3.7 million metric tons). Presumably, there were also shouts and murmurs from countries outside Russia where Rusal holds a significant stake in mines, plants, and smelters, such as Australia, Ireland, Guinea, Guyana, Nigeria, and Sweden. On April 23, Treasury Secretary Mnuchin addressed the complaints, explaining:

> *RUSAL has felt the impact of U.S. sanctions because of its entanglement with Oleg Deripaska, but the U.S. government is not targeting the hardworking people who depend on RUSAL and its subsidiaries. . . . RUSAL has approached us to petition for delisting. Given the impact on our partners and allies, we are issuing a general license extending the maintenance and wind-down period while we consider RUSAL's petition.*[12]

On that day, OFAC issued General Licenses 12A and 14, which extended the deadline for counterparties to disengage from Rusal from May 6 to October 23. A week later, on April 30, 2018, Mnuchin said in a *Bloomberg* interview that the sanctions on Rusal could be lifted if Deripaska "sells down below 50 percent," and added that "[o]ur objective was not to put Rusal out of business and that's why we extended the license."[13]

These statements and events raise a number of troubling questions. Ambassador Haley must have had reason to say that more sanctions were coming when she spoke on *Face the Nation*, but apparently any such sanctions had either been abandoned by the time she spoke and no one informed her, or there was an abrupt change of policy after she spoke. Director Kudlow seemed to imply it was the former. Also, Secretary Mnuchin appears to have gotten his numbers wrong when he implied that Deripaska owned more than 50% of Rusal, which would be a controlling interest, when in fact Deripaska then held only a 48.13% indirect and a 0.23% direct stake in the company, i.e. a non-controlling interest, which under the 50 Percent Rule would not by itself have caused Rusal to be sanctioned. Moreover, either U.S. policymakers had no idea that sanctioning Rusal would cause such turmoil in the aluminum market or that risk was known but went unheeded by the ultimate decision makers. It cannot, after all, have been an accident that Rusal was made an SDN because it was sanctioned in two distinct ways: *directly* by naming Rusal an SDN and also *indirectly* by sanctioning Deripaska and Vekselberg, who in the aggregate then owned, indirectly, nearly 75% of the company, thereby triggering the 50 Percent Rule. After creating a first-class muddle, the Treasury Department set about trying to undo the damage. Deripaska's team and Secretary Mnuchin sought a way out of a burgeoning crisis.

11 See, Davis Richardson, "Larry Kudlow Belittles Nikki Haley's 'Momentary Confusion' Over Russian Sanctions," *Observer*, Apr. 17, 2018, at https://observer/com/2018/04/larry-kudlow-nikki-haleys-momentary-confusion-russian-sanctions/.

12 "Treasury Extends Wind-Down Period for United Company RUSAL Plc," U.S. Treasury Department, at https://home.treasury.gov/news/press-releases/sm0365.

13 Saleha Mohsin & Stephanie Flanders, "Mnuchin Says U.S. Isn't Looking to Put Rusal Out of Business," *Bloomberg*, May 1, 2018, at https://www.bloomberg.com/news/articles/2018-04030/mnuchin-says-u-s-doesn-t-seek-to-put-rusal-out-of-business.

The Barker Plan

The Treasury Department and Rusal therefore began negotiations to lift the sanctions on the company, and OFAC issued several more general licenses that allowed Rusal's counterparties to continue to do business with the company in the meantime. Rusal's point man for the negotiations was Gregory Leonard George Barker, a.k.a. Baron Barker of Battle, former British Minister of State for Energy and Climate Change. Thanks to his involvement, the plan to have sanctions against Rusal lifted is commonly called the "Barker Plan." The negotiations ran from April to December 2018.

On December 19, 2018, the Treasury Department, as required by CAATSA, notified Senator Mitch McConnell that it had reached a proposed agreement under the Barker Plan. Under a "Terms of Removal Agreement," Deripaska would reduce his stake in Rusal and the company would be released from sanctions by January 30, 2019, assuming Congress did not scuttle the plan after a mandatory one-month review period. As it turns out, on January 16, the Senate voted 57 to 42, which was three votes short of the 60 votes necessary to pass Senate Joint Resolution 2 disapproving of the termination of sanctions on Rusal, EN+, and another of Deripaska's companies, EuroSibEnergo, in accordance with the Treasury Department letter to McConnell outlining the Barker Plan. Notwithstanding the Senate vote, the House voted 362 to 53 the next day against the Barker Plan in a purely symbolic act of disapproval.[14] Senator Chuck Schumer then tried to convince McConnell to have the

Oleg Deripaska. (Source: Wikimedia Commons)

Senate consider the merits of the plan despite its January 16 vote, but McConnell blocked that initiative. The Barker Plan thus survived congressional review.

The plan imposed changes in the ownership structure and board composition of both EN+ and Rusal. With regard to EN+, the company holding Deripaska's indirect stake in Rusal, the main provisions of the plan included the following: Deripaska's stake in EN+ is reduced from 68.47% to 44.95%; state-owned VTB[15] increases its stake from 9.62% to 21.68% by acquiring shares from Deripaska in exchange for debt forgiveness; Glencore swaps its 8.75% stake in Rusal for a 10.55% stake in EN+; and Deripaska donates 3.22% of his holding in EN+ to his charity Volnoe Delo. Though Deripaska ends up with a 44.95% stake in EN+, he will not be able to vote more than 35% of those shares; the balance will be held in a trust that must vote in line with the majority of the non-Deripaska shareholders. Also held in trust are the shares owned by Deripaska's family members and the charity,

14 Why the Senate vote was close and the House vote was not can perhaps be explained by the fact that the former was definitive whereas the latter was symbolic, which made it easier for many House Republicans to register their rejection of the Barker Plan without fear of betraying their party on an issue that mattered.

15 The Russian state currently owns at least 60.9% of VTB.

Table 1: Pre- and Post-Barker Plan Ownership Structures of EN+

Owners	Pre-Plan Equity Stake	Plan Ownership Post-Plan Equity Stake	Structures of Post-Plan Voting Right	Post-Plan in Trust
Deripaska	68.47	44.95	35.00	9.95
VTB	9.62	21.68	7.35	14.33
Glencore	0.00	10.55	10.55	0.00
Family	7.55	6.75	0.00	6.75
Charity et al.	0.00	6.64	0.00	6.64
Float	14.36	9.42	9.42	0.00
Total	100.00	100.00	62.32	37.67

Source: Polina Devitt & Arshad Mohammed, "Questions linger over Deripaska's influence after U.S. deal," *Reuters*, Feb. 4, 2019, at www.reuters.com/articles/us-isa-russia-sanctions-rusal-analysis/questions-linger-over-deripaska-rusalinfluence-after-u-s-deal-idUSKCN1PTOK9. The figures are rounded to two decimal points.

Table 2: Pre- and post-Barker Plan Ownership Structure of Rusal

Owner	2016	2017	2018	Post-Plan
EN+	48.13	48.13	48.13	56.88
Sual	15.80	20.50	26.50	26.50
Onexim	17.02	6.00	0.00	0.00
Glencore	8.75	8.75	8.75	0.00
Management	0.26	0.02	0.02	0.01
Public	10.04	16.60	16.60	16.60

Source: See, Rusal webpage, at https://rusal.ru/en/investors/to_shareholders/structure/ and Rusal 2017 Consolidated Financial Statement, at https://rusal.ru/upload/iblock/b75/UC_RUSAL_FS_30_September_2018_ENG_signed.pdf. The figures are rounded to two decimal points.

as well as the shares that VTB acquires from Deripaska.[16]

EN+ will have a twelve-member board of directors, eight of whom will be independent of Deripaska. Deripaska will be able to nominate only four directors. On January 28, 2019, seven independent board members were announced, including Christopher Bancroft Burnham, former Assistant Secretary of State for Resource Management and Chief Financial Officer of the U.S. Department of State.[17] The eighth independent director is the aforementioned Lord Barker, who will stay on as chairman.[18]

As for Rusal, EN+ will increase its stake under the Barker Plan from 48.13% to 56.88% and have the right to nominate the CEO. Deripaska will reduce his direct stake in Rusal to 0.01%.

The Rusal board will have fourteen members, eight of whom are independent of Deripaska, as is the chairman. The other six must have no business, professional, or family ties to Deripaska, although they may be employed by Rusal. The chairman of Rusal's board of directors, Putin's friend and former captain in the East German State Security Service (STASI), Matthias Warnig, had to resign. In December 2018, Warnig was replaced by the Frenchman Jean-Pierre Thomas, a former Sarkozy advisor and founder in 2017 of the pro-Russian International Association of Friends of Crimea. But less than a month later, in January 2019, Thomas too was forced to resign at the insistence of OFAC, presumably owing to his enthusiasm for Russia's occupation of Crimea.

By January 28, 2019, when the plan survived the vote in Congress, the price had risen to HK$3.26, almost 50% higher, though still some 30% lower than it was before the sanctions.

The Barker Plan spelled relief for Rusal and EN+ on the operational level.[19] On December 19, 2018, when the plan was presented to Congress, the Rusal share price was HK$2.24, roughly where it had been since the sanctions were imposed the previous April. By January 28, 2019, when the plan survived the vote in Congress, the price had risen to HK$3.26, almost 50% higher, though still some 30% lower than it was before the sanctions. The EN+ share price also rose sharply, from US$5.4 to over US$8, though that price was still far below the US$12-14 range it had been trading at before the April 2018 sanctions. The plan also brought calm to the aluminum market by easing fears of a supply shortage, with the spot aluminum price dropping to $1,853.72 in January 2019, its lowest level in almost two years.[20]

16 The four trustees are: David Crane, senior operations manager of Pegasus Capital Advisors; D. J. Baker, a corporate lawyer; Ogier Global Nominee (Jersey) Ltd., which advised EN+ on its IPO; and Arthur Dodge, managing director of Cerberus Capital Management. See, "Rusal Free: what will happen to the company after release from U.S. sanctions," RBC (in Russian), Jan. 28, 2019, at https://www.rbc.ru/business/28/01/2019/5c4e1ee09a79476da63c4bc8?.

17 The other members are Alexander Chmel, Carl Hughes, Nicholas Jordan, Igor Lojevsky, Joan MacNaughton, and Andrey Sharonov.

18 Deripaska will also execute a deed letter whereby he agrees not to act in any manner that enables him to control the management or policies of EN+ or Rusal. EN+ and Rusal will provide OFAC with quarterly reports.

19 Deripaska, in contrast, is apparently still under pressure. Under the Barker Plan, all dividends otherwise due him from Rusal and EN+ will go into a blocked account and not be freed until he has been released from sanctions. By his own calculation, sanctions have caused his net worth to fall by 81%, from about $9.3 billion to about $1.6 billion. See, Complaint for Declaratory and Injunctive Relief dated Mar. 15, 2019 in the case captioned Oleg Deripaska v. Steven T. Mnuchin, et al., case no. 1:2019cv00727, in the United States District Court for the District of Columbia, at para. 44.

20 See, Aluminum Futures End of Day Settlement Price (for unalloyed primary ingots, high grade, minimum 99.7% purity), at https://www.indexmundi.com/commodities/?commodity=aluminum&months=300.

What the Kremlin Learned

From this "chaotic, incomprehensible mess," the Kremlin must have concluded, if it did not know already, that U.S. policy toward Russia can be erratic because it is the result of infighting, an apparent lack of coordination, and perhaps also ignorance or even negligence. When the U.S. threw the aluminum market into turmoil on April 6, 2018 only to give it a reprieve through sanctions waivers two weeks later, it appeared that little or no attention was paid to roiling the market. When Director Kudlow impugned the mental health of Ambassador Haley, calling her "confused," there was plainly a failure to confer and coordinate. And when Secretary Mnuchin on May 1, 2018, told *Bloomberg* that sanctions against Rusal may be lifted if Deripaska's stake in the company is reduced to below 50%, *when Deripaska's stake was already below 50%*, one could only conclude that the Director, Ambassador, and Secretary were not reading from the same script, assuming there was a script.

The Kremlin will smell an opportunity in this confusion and try to reach sympathetic ears in the U.S. policymaking establishment. The only question is how.

The Kremlin will smell an opportunity in this confusion and try to reach sympathetic ears in the U.S. policymaking establishment. The only question is how. The Russia-hawks in Washington will not answer the Kremlin's call, whereas the Russia-doves will be wary of taking the call for fear of seeming collusive. A neutral intermediary is needed, and one is at hand: the "partners and allies" of the U.S. whose complaints may be safely heeded by both hawks and doves. The degree to which U.S. actions may harm the interests of its partners and allies will temper the extent to which the U.S. can act against Russia. This is not a sentimental consideration, nor is it a case of appeasing allies; it is a matter of not getting too far out ahead of them. Should U.S. partners and allies feel that their interests outweigh the benefit of toeing the U.S. line on sanctions, they will resist and even circumvent U.S. sanctions. Thus, even if Russian words fall on deaf U.S. ears, Russia can see its interests protected indirectly through the agency of U.S. partners and allies, as happened in the case of Rusal.[21]

The Kremlin must also have learned that the mere pressing of a button at OFAC could crush a major industry in Russia. Previous sanctions had been annoying, not catastrophic. Now, it's clear that even a company whose main plants are in Bratsk, Krasnoyarsk, and Sayanogorsk—places where no foreign tank or plane has ever penetrated—is perhaps fatally vulnerable to capricious U.S. policy. This chink in Russia's armor could impair Putin's reputation as Tsar-Protector of Holy Russia from foreign foes, for there is no hiding such an act of economic aggression from the Russian public despite state control of most Russian mass media: within days of the April 6 sanctions, workers at Rusal's Siberian plants were expressing their concerns about possible redundancies and shut downs. Thus, apart from the specter of mass unrest, the Kremlin would presumably also like to avoid a public-relations disaster: erosion of its carefully cultivated aura of invulnerability.

21 It is also possible that European countries may seek to circumvent U.S. sanctions against Russia by creating a "clearing house" in the form of a special purpose vehicle, as was considered with regard to U.S. sanctions against Iran. See, Patrick Wintour & Saeed Kamali Dehghan, "European 'clearing house' to bypass US sanctions against Iran," *Guardian*, Nov. 6, 2018, at https://theguardian.com/world/2018/nov/06/European-clearing-house-to-bypass-us-sanctions-against-iran.

The Likely Russian Response

To protect themselves from unpredictable but potentially devastating sanctions, Russian companies will presumably take, and in many cases have probably already taken, defensive measures to shield their corporate, financial, and trading schemes. All of them will want to minimize the use of U.S. dollars and thereby circumvent the U.S. banks that interdict dollar transfers to and from SDNs. In fact, "de-dollarization" is already semi-official Russian policy.[22] Some vulnerable Russian companies will modify their ownership structure to exclude or mask high-risk shareholders.[23] Some will try to shift their client-base to places less susceptible to U.S. sanctions, such as China.[24] What works in a given case will always depend on the particular circumstances of the relevant industry.[25]

The Kremlin, in turn, can be expected to seek to enhance its ability to lobby those partners and allies of the U.S. that stand to lose the most from Russia-related sanctions. This could be achieved, for example, by merging a vulnerable Russian company into one that is less vulnerable because it provides essential goods or services to the partners and allies. The resulting conglomerate would then be able to pit the interests of the partners and allies, thus amplified by conglomeration, squarely against U.S. interests in sanctioning Russia. In essence, such a conglomerate would take the partners and allies hostage: sanction the conglomerate, and the hostages get hurt. The principle underlying this approach could therefore be called "too big to sanction."

The Kremlin, in turn, can be expected to seek to enhance its ability to lobby those partners and allies of the U.S. that stand to lose the most from Russia-related sanctions.

Perhaps, the best example of a Russian company too big to sanction effectively is Gazprom, which is at least 50% state-owned and currently supplies Europe with about 40% of its natural gas.[26] Although Gazprom is currently subject to so-called "sectoral sanctions,"[27] which bar U.S. persons from engaging in certain specified transactions with the company, it has not to date been named

22 See, Max Seddon, "Putin backs 'dedollarization' plan," *FT,* Oct. 2, 2018, at https://www.ft.com/content/02c3ecc2-c62f-11e8-ba8f-ee390057b8c9.

23 A notable case of this response to sanctions is the commodity trading company Gunvor Group, through which Rosneft, for some reason, once sold some 30-40% of its oil. On March 19, 2014, Putin associate Gennady Timchenko sold his 50%-stake in Gunvor to its Swedish founder, Torbjörn Törnqvist. The next day, March 20, 2014, Timchenko was sanctioned by the U.S..

24 See, Marc Champion, "Trump's Trade War Is Making Russia and China Comrades Again," *Bloomberg*, Nov. 5, 2018, at https://www.bloomberg.com/news/articles/2018-11-05/trump-a-trade-war-is-making-russia-and-china-comrades-again.

25 Rusal announced that it would be investing up to $200 million in a new aluminum rolling mill in Kentucky, which it will be supplying with aluminum from its plants in Siberia. See, Joe Deaux, "With Sanctions Lifted, Rusal to Invest in U.S. Aluminum Mill," *Bloomberg* , Apr. 15, 2019, at https://bloomberg.com/news/articles/2019-04-15/with-sanctions-lifted-rusal-to-invest-in-kentucky-aluminum -mill. This bold move may help protect the company from future sanctions by threatening the operations of the Kentucky plant if Rusal should again be made subject of sanctions.

26 The press reported that Gazprom is buying up two of its subcontractors, Stroygazmontazh, a.k.a. the S.G.M. Group, belonging to Arkady Rotenberg, and Stroytransneftegaz, belonging to Gennady Timchenko. Rotenberg and Timchenko, Kremlin insiders, are both SDNs. See, "RBK: 'Gazprom' buys its major subcontractors from Rotenberg and Timchenko," Kommersant (in Russian), Mar. 29, 2019, at https://www.kommersant.ru/doc/3925938.

27 "Sectoral sanctions apply to specific entities. . . . U.S. persons are restricted from engaging in specific transactions with these entities. Restrictions apply to new equity investment and financing for identified entities in Russia's financial sector; new financing for identified entities in Russia's energy sector; and new financing for identified entities in Russia's defense sector." "U.S. Sanctions on Russia: An Overview," Congressional Record Service, Jan. 2, 2019, at https://fas.org/sgp/crs/row/IF10779.pdf/.

as an SDN and its operations have not, it seems, been seriously impaired.[28] If, however, the U.S. were to designate it an SDN, which is a more draconian form of sanction that would effectively turn Gazprom into an untouchable entity, Europe could be expected to find ways to continue to do business with it, preferring Russian gas to solidarity with the U.S.

Finally, exposed companies, instead of being merged into less vulnerable ones, may see the state taking a new or larger stake in them, as happened under the Barker Plan when VTB increased its holding in EN+. Where else is a sanctioned Russian company to turn for help but to the state? Such incremental or "creeping" nationalization, whether by conglomeration or increased equity stakes, may in fact be the main unintended consequence of current U.S. sanctions policy against Russia. Deripaska has already alluded to this side-effect: the Kremlin is "watching like a hawk from above, to see how far this car will run . . . It is a great opportunity for the bureaucrats to have more toys to play with in Russia, where already 70 per cent of the economy is in state hands." [29]

28 See, Henry Foy, "Russia oil and gas groups shrug off sanctions," *FT*, Aug. 29, 2018, at https://www.ft.com/content/b5e2c322-ab87-11e8-e5de165fa619. Gazprom's long-term prospects under sanctions may be murkier. See, Tatiana Mitrova, "Western Sanctions on Russia's Oil and Gas Sector: A Damage Assessment," Carnegie Moscow Center, July 25, 1028, at https://carnegie.ru/commentary/76909.

29 Henry Foy, "Oleg Deripaska claims 'filthy lies' were behind US sanctions," *FT*, Apr. 16, 2019, at https://ft.com/content/bf)da3ac-11e9-b285-3acd5d43599e.

Playing into the Hands of Kremlin, Inc.

If U.S. sanctions do force Russian industry further into the hands of the Kremlin, one has to ask whether such inadvertent encouragement of Russian nationalization is in the interest of the United States. However paradoxical it may sound, the answer is probably "yes," but only in the long term because the concentration of Russian business in state-owned or -controlled entities, or in the hands of Putin's inner circle, is unlikely to foster Russian economic growth, diversification, or productivity. According a report by the Russian Federal Anti-Monopoly Service, between 2005 and 2015, the state's share in the Russian GDP doubled, from 35% to 70%, and between 2012 and 2015, the number of state enterprises tripled.[30] The same report characterized the current Russian economy as "capitalism of state monopolies."[31] Over roughly the same period, 2008-2017, the march of nationalization has been accompanied by economic stagnation, with Russia's average annual growth rate only 1.2% (in 2017, it was 1.5%, compared to 2.3% in the U.S. and 2.5% in the Eurozone).[32] As noted by Konstantin Sonin of the University of Chicago, with unemployment steady at just over 5% and high capacity utilization in manufacturing, the Russian "economy is stagnating at full capacity."[33] This means that higher oil prices are the only path to growth unless productivity is increased. But increasing productivity requires the kind of far-ranging structural reforms that Putin has been unwilling or unable to implement in the first nineteen years of his de facto rule. The nationalization of metal-bashing, essentially nineteenth-century industries threatened by sanctions, is not among these necessary reforms.

Sanctions may therefore help Putin in the short term, but they seem likely to undermine the Russian economy in the long term, and thereby damage the current Russian regime, which relies on the economy for patronage and rents.

Sanctions may therefore help Putin in the short term, but they seem likely to undermine the Russian economy in the long term, and thereby damage the current Russian regime, which relies on the economy for patronage and rents.[34] Thus, it seems that the U.S. may, however inadvertently, be encouraging some of the most self-defeating instincts of the Putin regime, in accordance with the spirit of Napoleon's maxim: one should "never interrupt an enemy when he is making a mistake." Or, to paraphrase a quote often attributed to Vladimir Lenin, U.S. sanctions may be handing Putin the rope with which he will strangle the Russian economy.[35] Whether this happens will become clear only in time.

30 Yekaterina Mereminskaya, "Russian Anti-Monopoly Service: State Doubles Presence over Past Decade," *Moscow Times*, Sept. 29, 2016, at https://www.themoscowtimes.com/articles/russia-state-doubles-economy-presence-over-past-decade- 55529.

31 Id.

32 Konstantin Sonin, "Russia's economic stagnation is here to stay for the near future," *Daily Star*, Feb. 6, 2018, at https://www.dailystar.com.lb/Opinion/Commentary/2018/Feb-06/436983-russias-economic-stagnation-is-here-to-stay-for-the-near-future.ashx.

33 Id.

34 On rent-extraction by the "ruling class" in Russia today, see, Grigory Yavlinsky, The Putin System (New York: Columbia University Press, 2019), at pp. 80-85.

35 The quote from Lenin, though probably apocryphal, is: "The capitalists are prepared to sell us the rope that we'll hang them with."

The Barker Plan Will Not Alter Putin's Risk-Benefit Analysis

Since the goal of Title II of CAATSA is to encourage Putin to refrain from "future influence efforts worldwide," not in twenty years but *now*, the immediate question is whether the Barker Plan and sanctions similar to those imposed on Rusal and Deripaska are hurting Putin.[36] There are four principal reasons why they are not.

First, the plan has not affected Putin either directly, by sanctioning him personally and freezing his assets, or indirectly, by crushing Rusal and thereby creating a real problem for the Kremlin. Rusal's employees stayed on the job throughout the negotiations that led to the Barker Plan, and Rusal is now operating as it was before—a happy ending for Rusal, and presumably for Putin, too.

Second, the potential image problem for Putin posed by the gross U.S. intrusion into Russian affairs (the forced restructuring of Rusal and EN+, mandated U.S.-citizen board members, and ongoing U.S. supervision of those companies) is manageable because the Russian media can simply refrain from reporting on this issue. Some 86% of the Russian population get their news from mostly state-controlled TV.[37] If the news does get out, most Russians will probably not be interested in or understand the plan. And even if the plan is understood, the Kremlin could probably spin it as a win for Russia: state-owned VTB acquired a sizeable stake in EN+ at the expense of a pair of unloved oligarchs. Schadenfreude for the elite—*zloradstvo*—runs deep among many Russians who endured the oligarch-riddled nineties.

Third, the humbling or even elimination of Deripaska will not impair Putin's power or prestige for the simple reason that Deripaska, whom the U.S. sanctioned as an "oligarch," is replaceable. This point requires a digression into what it means to be an "oligarch" in Russia today.

An oligarch, by definition, is one of a limited group of people who control or at least influence state policy, usually by means of their wealth. In the 1990s, when the term first gained currency in Russia, it aptly described a small group of businessmen who were largely responsible for Boris Yeltsin's reelection in 1996 and later exerted considerable influence over his administration, profiting greatly as a result. The core members of this group were referred to as the "band of seven bankers" (*semibankirshchina*),[38] a pun on the "band of seven boyars" (*semiboyarshchina)* who deposed Tsar Vasily IV during the Time of Troubles. It was they who made Yeltsin an offer he couldn't refuse: we will bankroll your reelection campaign if you allow us to acquire state-owned companies for a knockdown price. This pact was the infamous "loans-for-shares" deal, the original sin of post-Soviet Russian capitalism.

The heyday of these oligarchs occurred in the 1990s. As soon as Putin became president in 2000, their power began to wane. It was in that year that Vladimir Gusinsky was jailed until he surrendered the television network, NTV. The next year, Boris Berezovsky was pressured to hand over his television network, ORT. In 2003, Mikhail Khodorkovsky, then-Russia's richest man, was imprisoned, and his

36 Inflicting pain is key to effective sanctions. See, Richard Nephew "U.S. Sanctions Relief: Good for Russian Companies but Bad for Policy?," Columbia Center on Global Energy Policy, Jan. 11, 2019, at https://energypolicy.columbia.edu/research/commentary/us-sanctions-relief-good-russian-companies-bad-policy.

37 See, Elena Vartanova, "Russia," Media Landscapes, at https://medialandscapes.org/country/media/television.

38 The seven were Boris Berezovsky, Mikhail Khodorkovsky, Vladimir Gusinsky, Mikhail Fridman, Petr Aven, Vladimir Potanin, and Alexander Smolensky.

From left to right: Boris Berezovsky, Valdimir Gusinsky, Mikhail Khodorkovksy, Pavel Durov. (Source: Wikimedia Commons)

company, Yukos, was absorbed by the Russian oil giant Rosneft, headed by Putin's old friend and ally, Igor Sechin. Since then, Putin has successfully asserted his power over Russia's other business magnates. In 2014, the owner of the oil company Bashneft, "oligarch" Vladimir Yevtushenkov, was arrested, and his legal troubles continued until he handed Bashneft over to Rosneft. The same year, Pavel Durov, founder of a Russian version of Facebook called VKontakte ("In Contact"), was similarly squeezed out of his company, which passed to Alisher Usmanov, a Kremlin-friendly metals magnate.

After being stripped of their property, Gusinsky, Berezovsky, Khodorkovsky (after ten years in prison), and Durov all saw fit to leave Russia. Russia's surviving captains of industry who made the *Forbes* list of the "World's Billionaires" before Putin came to power know that the same could happen to them, and they have become mindful of maintaining cordial relations with the Kremlin. Where their financial clout once enabled them to dictate terms to the government, they have since become stewards of property that they do not really own but merely possess at the sufferance of the Kremlin.[39] As stewards, they are replaceable and therefore expendable should the interests of the Kremlin so require. Contingent on the Kremlin's good graces, their wealth is now less a badge of power than of weakness, rendering them beholden to the Kremlin in direct proportion to what they have to lose. They have no choice but to oblige the Kremlin, which is able to leverage their own wealth against them. A suitable name for this class of Yeltsin-era magnate is thus the *paleo-oligarch*.[40] And because, for all the reasons stated above, the paleo-oligarchs generally stay out of politics, one could also call them *non-political oligarchs*, in contrast to those whom Navalny calls the "political oligarchs."

Can there really be any doubt that the Kremlin, which in the past has jailed and exiled paleo-oligarchs to encourage them to surrender their businesses, would not also be prepared to see some of them undermined or ousted if that is what's necessary to spare the relevant industries from destruction through sanctions? Deripaska said just that to a judge

39 Property rights, though defined by law, are ultimately grounded in socio-cultural norms that reflect nothing more than the "willingness of the society and its institutions to acknowledge the right of a given person to make decisions about a particular economic asset." See, Yavlinsky, supra note 34, at p. 58.

40 See, William R. Spiegelberger, "The Sources of Post-Soviet Conduct," Foreign Policy Research Institute, at https://www.fpri.org/article/2018/12/the-sources-of-post-soviet-conduct/.

in Washington.[41] Is it plausible to contend that any of them are indispensable to the Russian economy or the Kremlin when so many have already come and gone? In the end, wasn't Georges Clemenceau right when he remarked that "the graveyards are full of irreplaceable people who have all been replaced"?

And *fourth*, the example made of Deripaska, Vekselberg, Rusal, and EN+ is unlikely to move other Russian "oligarchs" to break ranks with the Kremlin for the simple reason that they do not really have a choice between the West and the Kremlin owing to the sources of their wealth. There are two fundamentally different sources, which give rise to two distinguishable classes of oligarch, each laboring under unique constraints.

Deripaska's wealth, like that of most paleo-oligarchs, comes primarily from assets fixed to the ground: smelters and hydroelectric plants in Russia. The smelters and plants are not mobile. He is therefore at their mercy because he cannot move them, and they are at the mercy of the Kremlin because the Kremlin controls the army, police, and courts. The same goes for most of Russia's other major industries, such as oil, gas, metals, minerals, wheat, and cellular networks: they cannot be spirited abroad beyond the Kremlin's writ. Deripaska and the other paleo-oligarchs therefore have no choice but to *cope* with sanctions and to *comply* with the Kremlin.

In contrast, the members of Putin's inner circle, many of whom are also fabulously rich, generally derive their income from lucrative state contracts and sometimes shadowy intermediary companies that collect rents from state-owned entities. Perhaps, the most notable members of this circle are Arkady and Boris Rotenberg.[42] The multi-billion-dollar contract to build the Kerch Strait Bridge linking Russia to Crimea went to their company, the S.G.M. Group, Russia's largest builder of gas pipelines and electrical lines. These brothers are also part owners of *Platon*, the electronic toll collection system that sparked a number of protests when it was put into operation in late 2015. Relative newcomers, this class of businessmen long kept a low profile for obvious reasons and first came to the attention of the broad Russian public only when they were sanctioned by the U.S. in response to Russia's occupation of Crimea in 2014. These newcomers are Navalny's *political oligarchs*, but because they are relative newcomers, they may also be called the *neo-oligarchs*.

Neo-oligarchs are unlikely to disobey the Kremlin not because the Kremlin controls some immobile source of their income, as in the case the paleo-oligarchs, but because the Kremlin is their source of income.

Neo-oligarchs are unlikely to disobey the Kremlin not because the Kremlin controls some immobile source of their income, as in the case the paleo-oligarchs, but because the Kremlin *is* their source of income. As a result, sanctioning political neo-oligarchs, *pace* Navalny, is unlikely to accomplish more than preventing them from spending their rubles at the Côte d'Azur or Gstaad. Exhibit A in support of this view: many neo-oligarchs have been under stern sanctions for some five years now, but show not the least sign of breaking ranks. They would lose everything. Besides, they can still have a grand time in Sochi and Crimea.

Responding on April 5, 2018, to press reports that the U.S. would be imposing new sanctions on oligarchs and others the following day, Putin's press secretary, Dmitry Peskov, said, "It's been a long time since Russia had oligarchs.

41 See, supra note 19.

42 The relationship between Arkady Rotenberg and Putin dates back to 1963 when they enrolled in the same Russian self-defense ("sambo") club in Leningrad.

There are no oligarchs in Russia."[43] Deputy Prime Minister Arkady Dvorkovich elaborated by noting that 90s-era oligarchs were replaced by "good, hardworking businessmen who care about their country and earn money through responsible means."[44] Peskov and Dvorkovich probably intended to be wry, but "out of the mouths of fools and cheats, we may often get our truest lessons."[45] They were right: striking "oligarchs" with sanctions, whether neo or paleo, is tilting at windmills. They simply aren't what they used to be.

43 Adam Taylor, "Is Russia all out of oligarchs? It says it is," *Washington Post,* Apr. 6, 2018, at https://www.washinton post.com/news/worldviews/wp/2018/04/06/is-russia-all-out-of-oligarchs-it-says-it-is/?utm_term=.b0b50bede115.

44 Id.

45 Oliver Wendell Holmes, *The Autocrat of the Breakfast Table*, ch. 1.

A More Effective Approach

By relieving Rusal of sanctions while leaving them in place on Deripaska and Vekselberg, the Barker Plan may have placated U.S. allies, but it will do nothing to deter Putin from undertaking further influence efforts abroad. A different approach is needed that will hurt Putin without harming U.S. allies. This can be achieved by getting the *target* and the *timing* of sanctions right.

As for the target, the sanctioning of replaceable individuals who are unlikely to break ranks with the Kremlin should be abandoned in favor of sanctioning irreplaceable Russian industries. Should a plant in Siberia be forced to close for want of buyers of its product, the Kremlin will be presented with some knotty problems: local unemployment, lost revenue, and diminished prestige. A few such disasters and the Kremlin could be expected to think a bit harder the next time it contemplates foreign mischief. The primary target of sanctions should therefore be vulnerable Russian industries, not people. Whether the U.S. is willing to crush a Russian industry and thereby exacerbate its already fraught relations with Russia is another question, but targeted degradation of Russian industry would do much to implement the intent of Congress under CAATSA.[46]

As for timing, U.S. partners and allies that depend on a targeted Russian industry must be given time to make alternative arrangements. This can be accomplished simply: the Treasury Department should announce that sanctions will be imposed on a given Russian company only after a relatively long grace period of perhaps nine months to a year, during which time the partners and allies could find new sources of supply. Although alternative sourcing may be difficult or impossible in industries where Russia is a near-exclusive supplier, in most others, like the aluminum industry, the market should be able to adjust to the loss of a single Russian producer. Chinese mills alone could *easily* cover the loss of Rusal production (3.7 million metric-tons per year) with their "massive" excess capacity of at least ten million metric tons per year,[47] but other producers too could presumably ramp up production to cover any lingering shortfall. An ancillary benefit of this delayed-sanction approach would be that a small but noticeable wedge could be driven between Russia and China. At a time when China's growth rate is slowing, there is a good chance that China would not hesitate to prefer the interests of its domestic producers to those of Russia. After all, the People's Republic, though run by the Communist Party, is not a non-profit organization.

As matters stand, the Barker Plan does not carry out the will of Congress under CAATSA to inflict pain on the Kremlin. Sanctioning people will not alter Kremlin conduct. People are replaceable. Only the serious impairment a major Russian industrial or financial asset after sufficient advance notice will serve the dual purposes of (a) convincing the Kremlin that the costs of foreign meddling outweigh the benefits, and (b) protecting the interests of U.S. partners and allies. Until that is done, the impression will linger that the President of the United States and Secretary of the Treasury, for reasons known only to them, are merely pretending to get tough with the Kremlin. The Russian phrase for this kind of behavior is *sploshnaya pokazukha*—all pretense, no substance.

46 What happens in coming months to another of Deripaska's sanctioned companies, the automobile and light truck manufacturer GAZ, may show how serious the U.S. is about imposing pain. The current OFAC license permitting counterparties to do business with GAZ is scheduled to expire on July 4, 2019. It is unclear whether the license will be extended. In the meantime, the company is said to be in difficulty. See, Henry Foy, "Conspiracies swirl as US sanctions hit Deripaska's car factory," *FT*, Apr. 25, 2019, at https://www.ft.com/content/725bdf6a-60e2-11e9-b285-3acd5d43599e

47 Henry Sanderson & Michael Pooler, "Western aluminium makers face new threat," *FT*, Sept. 18, 2016, at https://www.ft.com/content/0e8bdf98-7032-11e6-9ac1-1055824ca907.

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