

NEWSLETTER

INTERNATIONAL

 ENGLISH VERSION

RUSSIA



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SANCTIONS: OVERVIEW AND RECOMMENDATIONS ▶

„SANCTIONS ARE THE MAIN TOPIC FOR EUROPEAN BUSINESSES“

What economic development do you expect for 2019 in Russia?

Our view does not differ significantly from the assessment of the Russian government. There should be growth of approx. 1.5 percent in 2019. That is better than what we saw in 2015 and 2016. However, higher economic growth would be desirable for Russia to catch up internationally.

The Russian government has been promoting export heavily for some time. How do you see the potential for this?

With the devaluation of the rouble in 2014 and 2015, the competitiveness of the Russian economy has risen. As a result, European companies are now exporting from Russia, for example in the automobile industry. This is a new and so far still small development. If the rouble does not appreciate and this trend continues, then industrial exports can make up a growing share of the Russian economy.

Do Russian companies seize these opportunities?

The structure of Russian foreign trade is so far constant. There have always been mainly commodity exports and this segment continues to be the strength of the Russian economy. However, this is also its weakness, because the dependence on commodity prices is and remains dominant.

Economies usually do not restructure under new conditions quickly. Even in times of crisis, profits in the commodities sector are highest. Accordingly, the largest investments go there.

How do sanctions affect the business of European companies in Russia?

The sanctions are currently the main topic in the European business world, especially the US-sanctions. The uncertainty surrounding potential further US-sanctions prevents investment decisions by European companies, which continue to be the main investors in Russia.

An AEB poll showed that sanctions are a problem for 80 percent of European companies. The US-sanctions have very concrete effects on their business in Russia.

What steps are being taken in the EU to lift sanctions?

We are in close contact with the structures in Brussels. We are discussing with them and expect European interests to be defended against the US. The problem is that Europeans are not in agreement on the US-sanctions.

The US position in the international financial markets is so strong that it is difficult to



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develop a strategy that would lead to independence from US-decisions. This requires structural changes and also a common will of the Europeans. It is conceivable that individual states such as Germany or France set up structures to cooperate with Russia, bypassing American sanctions. But such measures take time.

How do you rate the controversy surrounding Nord Stream 2? Do you think the arguments of the project's opponents are plausible?

I believe Nord Stream 2 will be built, no matter if the US impose sanctions or not. The question is rather what the investor structure will look like - if need be, Russia will implement the project on its own.

The situation in the gas market speaks in favour of Nord Stream 2. Firstly, liquefied gas is too expensive; secondly, Germany needs more gas due to its policy of energy transition. The supply gap can only be closed by Russian gas. The completion of Nord Stream 2 is therefore beneficial for Germany and the EU.

Dependence on Russia will gradually increase, but this is a mutual dependency. The EU is the largest buyer of Russian gas, which also means that much of the Russian revenue comes from Europe. I believe that this interconnection is an important factor in keeping both partners in business and in dialogue.

What recommendations do you give to European companies regarding Russia?

In my view, the Russian market has a lot of potential. Real wages have risen in the past few months, which is good news for the consumer goods and retail sectors after the decline in previous years.

Trade between Russia and the EU is developing positively. If the political situation does not deteriorate and no hard US sanctions are imposed, then Russia can grow again - also through new direct investment from the EU. However, Russia needs to catch up regarding large productivity gaps. European companies can help to remedy this deficit.

“OPPORTUNITIES GET OUT OF SIGHT”

Media coverage of the Russian economy is dominated by sanctions and the quarrels surrounding Nord Stream 2. To what extent are these topics important in the daily business of your clients?

The media’s interest in the sanction topic and the diplomatic dispute over the major pipeline project is understandable. However, it is easily overlooked that much of the European business in Russia is not directly affected by the sanctions and can continue to operate. Other factors shape the business climate in Russia at least as significantly as the reciprocal sanctions: the decline in the rouble exchange rate since 2014 and the pursuit of an import substitution policy by the Russian government.

The weak rouble makes imported products more expensive and has therefore increased the competitiveness of the domestic economy. At the same time, the Russian government is disadvantaging foreign companies in tenders if they do not produce in Russia. Mainly these two factors force European companies to change their business model – the “traditional” export model is no longer feasible in many industries.

The debate surrounding Nord Stream 2 is unlikely to affect companies that are not directly involved in the project. However, the controversy is negatively influencing the perception of the Russian economy as a whole. Especially in smaller companies, this can lead to the chances of the market being overlooked and the potential there not being exploited.

What kind of assignments are you currently mainly involved with?

We have been observing for years that the number of new companies coming to Russia is declining. Of course, a large part of the relevant European companies is already working in Russia anyway, so that the numbers of new entrants are “naturally” declining. I assume, however, that companies postpone investment decisions regarding Russia due to the uncertainty regarding further political and economic developments.

Thus, we currently work mainly for companies that have been active in Russia for some time. The mandates are re-appointments or new leadership roles related to expansions. We have placed parts of the management teams in connection with several factory openings over the last years.

In which sectors and regions is the demand currently the largest?

Last year, the food sector and its neighbouring industries were again particularly active, such as the packaging sector. The trend towards expanding production capacities is also continuing in the pharmaceutical industry.

About half of our assignments last year were related to Moscow. The other projects were spread geographically across western and central Russia to the Urals.



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What queries do you receive from Russian companies? Are Russian companies taking advantage of export opportunities arising from the weak rouble?

In my opinion, the Russian government in particular has recognized that opportunities for domestic companies are emerging under the new framework conditions. Meanwhile, there are also relevant promotion instruments, such as the Russian Export Centre. Their effectiveness, however, has yet to prove itself. It is also unclear to what extent Russian entrepreneurs are generally interested in cooperating with state organs.

While the major Russian corporations are for the most part firmly integrated into the world market, medium-sized companies are finding it more difficult to internationalize. Many lack the expertise to build an international distribution system. Not all companies recognize the need to invest in sales and service. But even a good and attractively priced product does not sell itself.

Most requests from Russian companies to us concern recruiting a foreign specialist to solve a narrow business problem. This may involve setting up cheese production, building greenhouses in southern Russia or optimizing processes in a power plant. We have access to relevant specialists in Europe and have placed several such positions in recent years.

SANCTIONS: OVERVIEW AND RECOMMENDATIONS

Which areas do the American, European and Russian sanctions currently affect?

The EU and US sanctions against Russia can be divided into personal and industry related sanctions, including prohibitions regarding Crimea and Sevastopol. Personal related sanctions concern entry bans, freezing of assets and prohibitions of business activities with those sanctioned individuals.

Industry related economic sanctions include an arms and military embargo, restrictions for certain areas of oil production, dual-use goods and financial services. The US sanctions are partly broader than the EU sanctions and in particular additionally refer to areas such as metal construction, mining or engineering. With regard to Crimea, the US sanctions prohibit import, export and business activities completely. The EU sanctions prohibit import and tourism services, restrict investment in certain areas and prohibit the delivery of certain listed goods.

In 2014 Russia already imposed, as a countermeasure, an import ban for agricultural goods. This, among others, included meat, fish, fruits, vegetables, nuts and dairy products.

In Russia, on June 4th 2018, a new federal law came into force regarding "countermeasures concerning impolite actions by the United States of America and other



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foreign countries” which authorizes further Russian counter sanctions such as import and export prohibitions or restrictions regarding privatization measures. However, there are no concrete implementation measures of this law yet.

How and where can a company ascertain whether a planned business is in violation of a sanction?

Companies should keep in mind that violating sanctions involves high risks. Penalties for sanction violations are high and a defense against liability claims due to lack of intent or ignorance is usually not possible. It is therefore important for companies to be aware of their risks and to review both planned and ongoing business activities accordingly. It happens, that companies have been unaware that their business involves sanction-related risks for years. It should also be noted that all sectors are affected and that banks are no longer the sole focus of supervisory authorities.

Each European company is obliged to establish a professional and reasonable compliance procedure in order to perform respective compliance checks, including sanctions check measures. In this context, it is recommended that companies implement a group-wide sanctions compliance framework, also to meet the minimum due diligence standards required by the US supervisory authorities.

The benefit of a sanctions compliance framework lies in the effective bundling of competencies and activities as well as in the establishment of a centralized, group-wide and uniform compliance management. In this way, companies can ensure that sanction regulations are observed group-wide and that ignorance does not lead to sanction violations.

Furthermore, a compliance framework should also define roles and responsibilities and thus strengthen sanction awareness within the company. A company-wide awareness of sanctions issues and obligations is an indispensable prerequisite for minimizing sanctions-related risks.

Each compliance framework focuses on control and monitoring. Globally accepted and recognized databases as well as screening tools help to check clients and their shareholders. Appropriate export control software helps companies to control whether a specific product is subject to EU sanctions. Controlling and monitoring is particularly important because it not only identifies gaps, but also prevents violations.

Why are European companies subject to the American sanctions?

a) Primary application of the sanctions

Generally, the US sanctions have to be observed by US citizens or US companies (established according to federal US law or law of the state in which the company was founded including their branches abroad, regardless of their place of residence and/or company domicile). Thus, US sanctions are relevant for all US citizens working for a European company.

US parent companies of European companies as well as US affiliated companies are direct subjects to US sanctions and have to observe those as an US person. In addition, US officials generally consider the entire corporate group. Therefore, it cannot be excluded that activities of a European affiliate can be ascribed to an US company.

Moreover, US sanctions have to be observed by non-US persons who are physically staying in the US, are domiciled there or are US Green Card holders.

b) Secondary application of the sanctions

Problematic are so-called secondary sanctions against non-US citizens, in case they have business relations to a significant extent („significant transactions“) on behalf of a sanctioned Russian individual. Art. 228 CAATSA states that the U.S. President shall impose sanctions with respect to a foreign person if he determines that the foreign person knowingly, on or after the date of the enactment of the Countering Russian Influence in Europe and Eurasia Act of 2017

(1) materially violates, attempts to violate, conspires to violate, or causes a violation of any license, order, regulation, or prohibition contained in or issued pursuant to any covered Executive order, the CAATSA, or the Ukraine Freedom Support Act of 2014
or

(2) facilitates a significant transaction or transactions, including deceptive or structured transactions, for or on behalf of any person or (further described relative) subject to sanctions imposed by the United States with respect to the Russian Federation.

Which legal consequences can a breach of a sanction have?

The respective EU Council Regulations do not contain rules on penalties applicable to infringements of its provisions. Such rules are laid down by the EU member states and the EU member states must ensure that they are implemented.

German criminal and administrative penalties in relation to infringements of EU restrictive measures (sanctions) are regulated in the Foreign Trade and Payments Act (Außenwirtschaftsgesetz – AWG) and in the Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung – AWV).

In case of intentional violation of restrictive measures (economic sanctions) of the EU, a prison sentence from three months up to five years can be imposed. Attempted perpetration is punishable as well.

If the restrictive measures are violated negligently, it is considered an administrative offence and can be punished by a fine of up to five hundred thousand euro according to Sec. 19 (6) AWG.

In practice, in cases of violations of EU sanctions, Sections 130 and 9 of the Act on Regulatory Offences (Gesetz über Ordnungswidrigkeiten – OWiG) are usually

applicable, as a negligent or intentional breach of duty of supervision (Aufsichtspflicht) of the executive board / management is regularly assumed if offenses or administrative offences have been committed out of the company. The maximum fine imposed on the executive board / management (individuals) for such cases is one million euros. Regardless of the administrative liability of the executive board / management, an administrative penalty in the amount from five to ten million euro can be imposed on the company in accordance with Sec. 30 OWiG.

Also, a breach of US sanctions may lead to criminal liability and/or fines. Regarding non-US companies there is a risk of consequences in case they conduct significant transactions with listed individuals or companies. This could even lead to a listing of the concerned non-US company as a sanctioned company, which usually leads to complete paralysis of the company.

In connection with the requirements of US sanctions programs, companies should be aware of the following risks:

- **Financial and risks**

Fines imposed by the US regulatory authorities are known above all for their extreme high amounts. Moreover, monetary fines and settlements do not only depend on the volume of the conducted business. Transactions with a smaller volume may well represent a high risk. Furthermore, a breach of sanctions regulations may result in the exclusion from the US currency market or a ban on all US imports and exports. These measures can lead to partial or complete paralysis of the company. Also, US sanctions are subject to extremely strict liability rules, which preclude the defenses of liability claims based on lack of intent or ignorance. Moreover, according to US sanction regulations, even the mere proof of negligence in relation to economic sanctions is punishable by law. It is often of secondary importance whether a violation of relevant economic sanctions has actually taken place.

- **Reputational risk**

Violating sanction requirements can lead to a significant loss of reputation. In this context, it should be taken into account that US business partners (especially banks) may require safeguards or even contractually govern the implementation of such. There is a potential risk that business transactions will be rejected. In general, this can have an impact on the entire US business.

- **Risk for management and employees**

In the course of investigations by US authorities there is the possibility that not only the company but also activities of individuals are being examined. This holds true for both, the management as well as employees.

Our recommendation

Companies should be aware of their risks and influencing factors regarding financial and economic sanctions in order to assess possible measures. Due to the complexity an individual assessment of the respective situation is required and concerns, apart from drafting a contract with Russian parties, an individual configuration of the organizational and operational structure. Non-US companies should be aware of their US connections and necessary risk mitigating measures regarding sanctions and if necessary, optimize those.

Influencing factors of both US primary as well as secondary sanctions should be thoroughly analyzed and documented in order to derive necessary safety measures.

Uncertainty in the face of legal insecurity in US law and the tendency towards ever new sanctions could have the effect on companies to restrict their business in and with Russia and thus to miss valuable business opportunities. Nevertheless, such drastic steps do not always have to be necessary and companies can meet the challenges resulting from complex sanction regulations with a well-functioning compliance framework.

A proper sanctions compliance strategy helps companies to act in accordance with their statutory obligations and contributes to the overall success of the company. It is therefore advisable to consider sanctions in the corporate strategy, especially against the background of a highly dynamic political environment.

Regarding contract negotiations with Russian parties, termination and amendment possibilities should be included. This is not always easy since Russian courts do not accept sanctions as a case of force majeure and the compliance with sanctions against Russia could be deemed bad faith. From a German point of view it should be examined and ensured that respective contractual regulations cannot be qualified as an illegitimate announcement of boycott according to § 7 AWW.



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