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Russia Trade Restrictions, Compliance Challenges Seen as 'New Normal'
By Ian Cohen

As global trade restrictions against Russia continue to increase, some companies are grappling with whether to fully exit the Russian market or rely on sanctions screening and temporary carve-outs to keep their operations afloat, lawyers and experts said in interviews this month. But the risks for a majority of businesses are quickly becoming too high, especially as sanctions are expected to grow more punishing.

“What businesses need to do is prepare for this as a long haul, and not a short haul,” said Nazak Nikakhtar, a Wiley trade lawyer and former acting undersecretary of the Bureau of Industry and Security. “There is no, ‘how can I walk the tightrope here?’ The sanctions are going to only increase in severity.”

Since Russia invaded Ukraine, the Biden administration has issued a nearly nonstop string of sanctions and export restrictions, many of them coordinated with allies (see 2202240069, 2203020072 and 2203040020). The restrictions have grown so severe, and the reputational risks of supplying services in Russia have grown too damaging, that many businesses have already retreated, including carmakers GM and Volvo, energy companies Shell and BP and several major steamship lines and express couriers, including Maersk, Hapag Lloyd and UPS (see 2203010024 and 2203010055).

As compliance teams scramble to keep up with the constant stream of restrictions, many companies are weighing whether their due diligence efforts are worth it. “You've got new rules coming out every day,” said Doreen Edelman, a trade lawyer with Lowenstein Sandler. “There's no way the average person or general company has someone devoted to this.”

Edelman is advising clients with business in Russia to “seriously be thinking about your backup plans,” either for exiting the market or to continue operations in a way that doesn’t intersect with U.S. sanctions prohibitions. While U.S. manufacturers may have an easier time leaving the Russian market if the region represents a minor portion of their sales, Edelman said that same calculus may be different for other companies, particularly for those in the financial services industry,

“Diligence and compliance are on the front burner,” Edelman said. “This is a very complicated Russian sanctions program.”

The most prudent path for many businesses may be to leave Russia entirely, Nikakhtar said, especially because sanctions are “only going to escalate.”

‘’The writing is on the wall. Start moving away,” Nikakhtar said. “It makes no sense for the short and the medium term, at least, to maintain any business over there.”

While the U.S. and allies have imposed sanctions on Russia's major banks, a range of government officials and oligarchs, the export controls are also "pretty broad," Nikakhtar said. "In terms of scope, you've got pretty much every Commerce Control List category impacted in some way, shape or form."

Aside from new restrictions on Russia's oil refinery sector, BIS also introduced two new foreign direct product rules that place license requirements on certain foreign-produced items destined to Russia and Belarus. And although some rules impose restrictions only when the exporter has "knowledge" that the item will be used by certain Russian or Belarusian entities, performing that due diligence can be difficult, Nikakhtar said, especially when dealing with foreign distributors.

"Even if you notify them that you can't forward the product to a specific end-user, how do you know if they're going to be honest with you? How do you know that they're not going to be coerced by the Russian military to get access to this equipment?" Nikakhtar said, adding that Russia has hindered the U.S.'s ability to conduct end-use checks for years.

"I think the important thing for everybody to realize is that these sanctions aren't going away," Nikakhtar said. "They are going to stay and they're only going to grow."

Companies that stay in Russia may increasingly turn to professional sanctions screening and export compliance solutions as they navigate an increasingly complex set of regulations. Jackson Wood, director of global trade intelligence for Descartes, said he's seeing an uptick in questions about the Office of Foreign Assets Control's 50% rule, which prohibits transactions with entities owned 50% or more by sanctioned parties.

Complying with the rule and other OFAC sanctions may be particularly important in Russia's extractive industries, Wood said, where many entities have ties to the government and ownership structures aren't always clear. "The burden of due diligence is significantly higher now because so many other individuals have been directly sanctioned," he said.

And without clear government guidance outlining due diligence expectations, compliance may grow even more challenging. Wood said governments are increasingly trending away from "explicit guidance" and more toward "directional-based guidance," which usually isn't as specific as industry would like.

"There are fewer and fewer explicit lists being published, and fewer and fewer very explicit considerations around things like export controls," Wood said. "Governments are more or less saying, here are our criteria, here are considerations, but the explicit due diligence is your responsibility."

The near-constant stream of Russia sanctions is increasing those due diligence challenges and could lead to a continued industry exodus from the country, Wood said. ”I think that's something that we're going to see a lot more of going forward,” he said. “Companies just saying, not only do we not want to deal with the regulatory challenges, we just don't want the optics of trying to figure out a way to keep doing business in a part of the world that is very volatile, and frankly may not burnish our image and reputation in a positive way.”

Compliance may be further complicated by the fact that there is no precedent for the present trade landscape, which features highly coordinated multilateral sanctions aimed at one country.“There's just no frame of reference for the scope and scale of these sanction actions," Wood said. Nikakhtar called the measures "unprecedented, hands down." Edelman said she has also never seen this level of sanctions coordination, which is only likely to continue. “What I'm being told by people in the upper echelons of policy is that this is going to be a new normal,” she said. “This is not going to be over quickly.”