

# Locke Lord QuickStudy: Russia Response to Western Sanctions – Nationalization

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Russia first invaded Ukraine in February 2014. This latest invasion started on February 24, 2022. As of mid-April 2022, over 750 international companies have publicly announced plans to curtail or shut down operations within Russia; for the most part, these withdrawal actions are in support of the Ukrainian people and are not legally required by sanctions. We do note that while the U.S. and its allies' sanctions against Russia are "targeted" at certain industries, the practicality of international trade with Russia is severely hampered by sanctions on Russian financial institutions making funds transfers into and out of Russia extremely difficult.

Russia is attempting to respond to the sanctions that it dubs as coming from "unfriendly nations" by threatening countersanctions, up to and including nationalization of assets of companies from those unfriendly nations that are within the grasp of Russia. Russian sources claim this is quid pro quo for the freezing of Russian U.S. dollar assets around the world. One effect of the freeze has been pushing Russia to the brink of default on its foreign debt. According to reports, the U.S. and its allies have frozen around \$315 billion of Russian U.S. dollar assets worldwide. Russia may use Rubles to pay its debts. However, its failure to deliver U.S. dollars would be a default under most of its debt agreements, and the Ruble has devalued significantly since the start of the latest Ukraine invasion; noting that in mid-March 2022, the Ruble has recovered from some of the losses.

On April 8, 2022, the Russian Federation's lower house of parliament, with Russian President Vladimir Putin's endorsement, passed proposed counter-sanction legislation (the "Proposed Legislation"). The Proposed Legislation would grant local authorities the right to nationalize the property and assets of companies from "unfriendly jurisdictions" who cease operations in the Russian Federation. Specifically, the Proposed Legislation would amend article 235 of the Civil Code of the Russian Federation to permit the forcible seizure of property rights and assets located in the Russian Federation owned by companies or citizens from jurisdictions unfriendly to the Russia Federation, including the United States, United Kingdom, Australia, European Union, Japan, and South Korea ("Unfriendly Jurisdictions"). While a vast majority of the Proposed Legislation is still subject to clarification through regulatory implementation, it is clear that the potential new law would apply to Russian companies with beneficial owners with 25% or greater, direct or indirect, ownership based in Unfriendly Jurisdiction.

Thus, for example, if a parent company located in an Unfriendly Jurisdiction decides to cease its operations in Russia, then members of the board of the Russian subsidiary or Russian Federation government officials could essentially request a Russian court to appoint an "external manager" for the Russian operations and take over that business. If you recall from our earlier [post](#), Russia has already cleared the way for theft of intellectual property by Russian businesses who were not already subject to contractual obligations to pay for non-Russian

intellectual property. ?

Based on our understanding of the Proposed Legislation, local Russian authorities would ?appoint a local manager to take control of businesses in cases where the prior owner has ceased ?Russian operations, thereby transferring the company’s assets to a newly created Russian entity. ?This action would essentially nationalize the asset to the Russian Federation. The original ?shareholders would not be compensated for the seized assets or even have the right to purchase ?interests in the newly created Russian entity. ?

Russian nationalization of this nature has begun to take form in the commercial aircraft space. ?News outlets have reported that Russia has taken for its own use over \$10 billion of leased ?commercial aircraft. As of the time of the latest Russian invasion into Ukraine, domestic ?Russian airlines leased about 515 foreign-owned planes which are valued at around \$10 billion. ?These aircraft, leased from foreign owners, are a significant portion of Russia’s fleet. Due to ?U.S. and allied sanctions, the foreign jet lessors are required to cancel leases with Russian ?airlines; but the Russian airlines are refusing to return the aircraft. Lessors are contacting their ?insurers for coverage on the lost aircraft, giving rise to the knock-on effect of whether there is ?insurance coverage or whether “act of war” exclusions may limit recoveries. Query with the ?state of relations, where will Russia get parts to keep foreign aircraft safe and airworthy, and ?will the manufacturers be permitted to sell parts to Russia under humanitarian general licenses.?

The Proposed Legislation is reminiscent of Cuba and Fidel Castro’s actions in 1960, when Cuba ?nationalized significant American owned assets located in Cuba. On August 6, 1960, following ?a stand-off with the U.S., the Cuban government nationalized all American owned oil refineries, ?sugar factories and mineral mines. The value of the oil assets alone seized in 1960 were ?approximately \$1.7 billion. ?

In previous attempts by Russia to nationalize foreign-owned businesses, foreign investors ?prevailed in arbitration. This could be the case again if Russia wants to maintain a seat at the ?international table. However, if Russia withdraws from international commerce similar to ?North Korea, Iran and Syria, there could be long-term effects of the confiscation of assets from ?U.S. and other Unfriendly Jurisdictions. Either way, based on recent developments, foreign ?companies with operations in or withdrawal from Russia should be prudent on how they handle ?their operations in Russia. ?

## **Conclusion**

This paper is intended as a guide only and is not a substitute for specific legal or tax advice. Please reach out to the authors for any specific questions. We expect to continue to monitor the topics addressed in this paper and provide future client updates when useful.

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