Sanctions Against Russia: Implications for Your Company (Cumulative Update as of July 17, 2014)

Gene M. Burd and Michael E. Burke

Executive and Legislative Developments

In response to Russia's occupation of Crimea and continued attempts to destabilize Ukraine, the United States and other nations have ratcheted up economic sanctions against Russia. The sanctions announced on July 16, 2014 are "sectoral" sanctions meant to put pressure on the entire sectors of the Russian economy. How these sanctions are implemented and their impact on international businesses is discussed in this update.

As this update was being issued, U.S. and European officials and their allies sternly criticized Russia for its apparent role in downing of the Malaysian flight MH-17. They warned Russia of additional consequences if it does not immediately cease its support of the rebels and allow for international investigation of the MH-17 disaster, which indicates possibility of yet another round of sanctions. We will update this release as the events warrant.

Beginning on March 2014, President Obama issued three executive orders E.O. No. 13660 (March 6, 2014), E.O. No. 13661 (March 17, 2014) and E.O. No. 13662 (March 20, 2014). Taken together, these orders enable the Secretary of the Treasury to sanction specific individuals and entire sectors of Russian economy, including financial services, energy, metals and mining, engineering and defense.

In addition, on April 3, 2014, President Obama signed into law Public Law 113-95 entitled Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act of 2014 (PL 113-95) which requires imposition of sanctions on the persons responsible for violence or undermining the peace, security, stability, sovereignty, or territorial integrity of Ukraine. The law also authorizes imposition of sanctions on the persons in Russia complicit in or responsible for significant corruption.

On April 28, 2014, the United States imposed targeted sanctions on a number of Russian individuals and entities and restricted licenses for certain U.S. exports to Russia. The Department of the Treasury imposed asset freezes and visa bans on seven Russian government officials and asset freezes on 17 companies. Further, the Department of Commerce has imposed additional restrictions on 13 of those companies by imposing a license requirement with a presumption of denial for the export, re-export or other foreign transfer of U.S.-origin items to the companies. Further, the Departments of Commerce and State have announced a tightened policy to deny export license applications for any high-technology items that could contribute to Russia's military capabilities. Those Departments also will revoke any existing export licenses that meet such conditions.

Two of the sanctioned companies are not based in Russia—one is based in Cyprus and the other is based in Luxembourg (presumably each is owned or controlled by Russian government officials or members of the inner circle of President Putin).

On June 20, 2014, the U.S. Department of the Treasury sanctioned seven Ukrainian separatists responsible for or complicit in actions or policies that threaten the peace, security, stability, sovereignty, or territorial integrity of Ukraine, and/or asserting governmental authority over a part or region of Ukraine without the authorization of the Government of Ukraine. These actions were taken pursuant to Executive Order (E.O.) 13660.

On July 16, Treasury imposed sanctions under E.O. 13662 that prohibit U.S. persons from providing new financing to two major Russian financial institutions (Gazprombank OAO and VEB) and two Russian energy firms (OAO Novatek and Rosneft), limiting their access to U.S. capital markets. In addition, Treasury designated eight Russian arms firms, which are responsible for the production of a range of materiel that includes small arms, mortar shells, and tanks. Treasury designated the "Luhansk People's Republic" and the "Donetsk People's Republic," which have asserted governmental authority over parts of Ukraine without the authorization of the Government of Ukraine and Aleksandr Borodai, the self-declared "prime minister" of the Donetsk People's Republic, for threatening the peace, security, stability, sovereignty, and territorial integrity of Ukraine. Treasury also designated Feodosiya Enterprises, a key shipping facility in the Crimean peninsula, because it is complicit in the misappropriation of state assets of Ukraine. Finally, Treasury designated four Russian government officials, including Sergey Beseda, a senior Russian Federal Security Service official under E.O. 13660 and E.O. 13661.

The imposed sanctions and their potential impact on businesses are discussed below.

Imposed Sanctions

<u>Asset Freezes.</u> To date, the Ukraine-related asset freezes (also called blocking)have been imposed on 57 individuals and 30 entities. Blocking is an immediate across-the-board prohibition against transfers or dealings of any kind with regard to the property of such persons. Blocking is **<u>not</u>** forfeiture because title to the blocked property remains with the target, but the exercise of powers and privileges normally associated with ownership is prohibited without authorization from Office of Foreign Assets Control (OFAC). As of the date of the imposition of sanctions, the assets are required to be separated, placed in trust and the person holding the assets is required to notify OFAC.

Blocking extends to the entities in which a sanctioned individual owns (defined as a direct or indirect ownership interest of 50% or more). As noted above, two of the newly-sanctioned entities are not based in Russia. This illustrates the scope and breadth of the Russian economy, and also shows that individuals/entities who must comply with U.S. sanctions should be aware that potential sanction targets can be located anywhere in the world.

- *Bottom line*: Financial institutions and businesses, especially those with Russian and Ukrainian counterparts, should screen existing and future customers, clients, and accounts against the names of the persons subject to the orders. Given the fluidity of this situation, additional persons and groups could be added to the list of targets for asset blocking. Therefore, it is advisable to check the list on a regular basis for updates. Ongoing long-term contracts with parties subject to sanctions may present additional risks requiring individual legal advice.

<u>No U.S. Entry.</u> The Ukraine-related sanctions ban 57 individuals from entering the U.S. In addition, entry may be denied to unlisted persons at the discretion of the Department of State.

- *Bottom line*: As with the advice on the first point, U.S. businesses must make themselves aware of whether current or potential clients or customers or are 'listed.' The ban on entry into the U.S. could impact the ability of U.S. companies to do business with 'listed' persons or entities.

<u>Prohibition on Donations.</u> Sanctions prohibit donations by or to sanctioned persons and entities.

- *Bottom line*: Non-profit organizations should review the list of their donors to determine whether any of the listed nationals are on their donor lists. Further donations from these persons are prohibited.

<u>Export Licensing Limitations.</u> Since April, the Bureau of Industry and Security (BIS) at the Department of Commerce, which oversees U.S. export control regulations as to 'dual-use' items, and the Directorate of Defense Trade Controls (DDTC) at the Department of State, which oversees U.S. export control regulations as to defense/military items, have

placed 'holds' on processing any export license application for end-users in Russia and occupied Crimea. The April 28, 2014 revisions to the Ukraine-related sanctions program upgraded DDTC's posture from a 'hold' to a 'presumption of denial' for future license requests for end-users in Russia and occupied Crimea. In addition, DDTC has begun the process of revoking existing export licenses for items that contribute to Russia's military capabilities whose end-users are in Russia or occupied Crimea.

Furthermore, effective April 28, 2014, BIS will deny pending applications for licenses to export or re-export any high technology item subject to the Export Administration Regulations (EAR) to Russia or occupied Crimea that contribute to Russia's military capabilities. In addition, the Department of Commerce is taking actions to revoke any existing export licenses which meet these conditions. All other pending applications and existing licenses will receive a case-by-case evaluation to determine their contribution to Russia's military capabilities.

Thirteen companies have been designated on the Entity List based on a determination they are involved, or pose a significant risk of becoming involved, in activities contrary to the national security and foreign policy interests of the United States. Designation on the Entity List imposes a license requirement for the export, re-export or other foreign transfer of items subject to the EAR to the designated companies (to any country), with a presumption of denial.

- *Bottom line*: Covered business with plans to export certain 'dual-use' or defense/military items to Russia or occupied Crimea should realize that it is unlikely, for the foreseeable future, that BIS or DDTC will review or approve any license application for an end-user Russia or occupied Crimea. This would cover transactions with any person or entity in Russia or occupied Crimea, not just those entities and persons included on the SDN List. Further, existing license holders may now have DDTC-issued licenses revoked. This would create some level of uncertainty, and risk, for already-concluded commercial contracts and accepted orders, and covered entities should review their agreements to ensure that export control risk is properly addressed.

<u>Prohibition of New Financing.</u> Treasury imposed measures prohibiting U.S. persons and persons within the United States from transacting in, providing financing for, dealing in new debt of longer than 90 days maturity or new equity for **OAO Gazprombank** and **VEB**, their property, or their interests in property. As a practical matter, this step will close the medium- and long-term U.S. dollar lending window to these banks, and will impose additional significant costs on the Russian Government for its continued activities in Ukraine.

Treasury also imposed measures that prohibit U.S. persons and persons within the United States from transacting in, providing financing for, or otherwise dealing in new debt of longer than 90 days maturity for Russian energy firms **OAO Novatek** and **Rosneft**, their property, or their interests in property.

Treasury, however, has not blocked the property or interests in property of these companies, nor does it prohibit transactions with them beyond these specific restrictions. However, Treasury indicated that the scope of the prohibited transaction types and the number of energy companies may be expanded under the authorities of E.O. 13662, if the Russian government does not take steps to de-escalate the situation in Ukraine.

- *Bottom line*: Any company no matter where located would be facing difficulties in providing new financing to the sanctioned entities because a significant amount of world financing is done in U.S. dollars. Any issuance of dollar denominated bonds or notes could implicate prohibitions imposed by E.O. 13662 because of the nexus with U.S. financial institutions. Sanctions would also impact providing of trade financing such as documentary letters of credits, bank guarantees (stand-by letters of credit) or similar instruments for the term longer than 90 days. Refinancing of the existing debt would also become challenging.

Who Must Comply With Sanctions

All U.S. persons must comply with OFAC regulations, including all U.S. citizens and permanent resident aliens regardless of where they are located, all persons and entities within the United States, all U.S. incorporated entities and their foreign branches. As discussed below, even foreign entities when engaging in transactions that have nexus with the United States may be required to comply with OFAC regulations.

Potential Penalties

Violation of sanctions can trigger substantial fines and even imprisonment. Civil penalties can range up to $250,000 or twice the amount of the underlying transaction for each violation. Criminal penalties can range to $1,000,000 in fines and up to 20 years of imprisonment.

- *Bottom line*: Companies should review their business operations with, and in, Russia, and determine how best to manage their operations in light of potentially tighter sanctions. For example, public companies may consider including a Russia sanction-specific risk factor in their filings. Companies may also consider whether to move more liquid assets out of Russia. Companies should also review their contracts with Russian exposure to determine whether they can be terminated in the event of sanctions or the consequences could be alleviated.

Compliance by Foreign Companies

Recent OFAC enforcement actions (BNP Paribas, Russian Bank of Moscow, UK Royal Bank of Scotland, and Luxemburg Clearstream Banking S.A.) demonstrate that compliance with US sanctions is expected of foreign institutions. Foreign and multinational companies face significant compliance risk if they engage in any business with sanctioned persons or entities. Even a minimal nexus with the United States in transactions with such persons can create liability. Activities to watch include clearing transactions in U.S. dollars, providing financial services through institutions in the United Sates, processing payments through foreign branches of U.S. financial institution, or knowingly relying on services of U.S. persons anywhere in the world to facilitate, participate in, approve, or support restricted transactions.

Sanctions by Other Countries

The EU, Canada, and Australia have imposed their own Ukraine-related sanctions against specific individuals and legal entities. The sanction include visa bans and assets freezing of persons responsible for undermining territorial integrity and stability of Ukraine, person responsible for transfer of assets in Crimea contrary to Ukrainian law, misappropriation of Ukrainian State funds, and human rights violations in Ukraine. See *Council Decision* 2014/145/CFSP (OJ L 78, 17.3.2014, p. 16); *Council Regulation* (EU) No 269/2014 (OJ L 78, 17.3.2014, p. 6); *Council Decision* 2014/119/CFSP (OJ L 66, 6.3.2014, p. 26); and *Council Regulation* (EU) No 208/2014 (OJ L 66, 6.3.2014, p. 1). Additionally, EU moved to suspend financing of new Russian projects by the European Investment Bank and European Bank for Reconstruction and Development.

The E.U. so far apparently will not sanction Russian companies. Misalignment of international sanctions would create a compliance challenge for U.S. companies.

- *Bottom line*: Multinationals should be aware of the potential misalignment between the focus of a U.S. sanctions program and a similar program administered in the European Union and Canada. Actions taken in the EU that would not be permitted under a U.S. sanctions program could be construed by U.S. regulators as evasion of the U.S. program — and such evasion is punished through significant fines. Companies should ensure that adequate compliance controls are in place to reduce such risk.

Russian Economic Retaliation

The Russian government has retaliated with sanctions imposed on a number of U.S. Senators, Congressmen and Obama administration officials. Given fluidity of the situation, more Russian sanctions are not out of the question, including termination of government contracts and confiscation of assets.

- *Bottom line*: Companies should determine whether they have political risk insurance that covers expropriation. If not, they should determine the quantity and quality of assets possibly at risk, and take appropriate protective steps.

We will continue to update this guidance as events warrant. Contact the authors if you have any questions.

Authors and Contributors

Gene M. Burd
Partner, DC Office
202.677.4048
gene.burd@agg.com

Michael E. Burke
Partner, DC Office
202.677.4046
michael.burke@agg.com

not *if*, but *how*.®

About Arnall Golden Gregory LLP

Arnall Golden Gregory, a law firm with more than 150 attorneys in Atlanta and Washington, DC, employs a "business sensibility" approach, developing a deep understanding of each client's industry and situation in order to find a customized, cost-sensitive solution, and then continuing to help them stay one step ahead. Selected for The National Law Journal's prestigious 2013 Midsize Hot List, the firm offers corporate, litigation and regulatory services for numerous industries, including healthcare, life sciences, global logistics and transportation, real estate, food distribution, financial services, franchising, consumer products and services, information services, energy and manufacturing. AGG subscribes to the belief "not if, but how.®" Visit www.agg.com.

Atlanta Office
171 17th Street NW
Suite 2100
Atlanta, GA 30363

Washington, DC Office
1775 Pennsylvania Ave., NW,
Suite 1000
Washington, DC 20006

To subscribe to future alerts, insights and newsletters: **http://www.agg.com/subscribe/**