

Ukraine-related sanctions: Key issues for companies

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What is the status of the evolving international sanctions against Ukraine and Russia?

Since the recent escalation of the Ukraine crisis in March, there have been almost daily developments regarding economic sanctions – ranging from details of implementation to proposals for new or tougher measures. This report provides a snapshot of the current sanctions, how they apply to companies doing business in or with Ukraine or Russia and their customers and counterparties, compliance requirements in different scenarios, and where sanctions might be headed in the near future.

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I. Current Sanctions

A. Who has imposed sanctions?

A number of jurisdictions have introduced sanctions measures in response to the situation in Ukraine, including the United States (US), the European Union (EU), Canada, and Australia, and other countries may do so. Russia also has responded with its own sanctions, imposing a travel ban on specified US officials. This report will focus on the main sanctions imposed by the US and the EU.

B. What are the current US and EU sanctions measures?

In March 2014, the US issued three Executive Orders pursuant to which the Obama administration has since imposed sanctions in March and April on 45 individuals and 19 entities.¹ These Executive Orders also set the stage for more sweeping sanctions that potentially may be imposed against individuals and entities in various sectors of the Russian economy.² In addition, on April 3, 2014, the US enacted legislation that supplements the Executive Orders and authorizes potential sanctions against additional categories of Ukrainian and Russian persons.³

In particular, the US sanctions issued to date require US persons (including US citizens, companies and banks incorporated in the US, including foreign branches, and any individual or entity located in the United States) to block (freeze) all property or interests in property of designated parties, where such property or interests in property are or come within the United States or the possession or control of US persons anywhere in the world. The US sanctions also prohibit US persons from engaging, directly or indirectly, in any dealings with, or for

¹ The entities include Bank Rossiya (designated on March 20, 2014), Chernomorneftgaz (designated on April 11, 2014; the designation refers only to the entity in Crimea at the address listed, and not its parent company), and 17 Russian banks and companies (designated on April 28, 2014).

² The Executive Orders (13660, 13661, and 13662) can be accessed here: <http://www.treasury.gov/resource-center/sanctions/Programs/Pages/ukraine.aspx>. The list that identifies designated parties (i.e., the Specially Designated Nationals and Blocked Persons List ("SDN List")) is maintained by the US Treasury Department's Office of Foreign Assets Control ("OFAC"), and can be accessed here: <http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx>.

³ The legislation, the *Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act of 2014*, can be accessed [here](#).

the benefit of, designated parties. Non-US entities also may be subject to these restrictions if they act in the United States or their transactions have some other US nexus. Designated individuals also are subject to a visa ban.

The Executive Orders also target entities that are owned or controlled by designated parties. As a general rule, entities with 50 percent or greater ownership interest held by a designated party, directly or indirectly, are deemed blocked by operation of law (together with designated parties, referred to as “blocked persons”), even in the absence of a specific designation. Absent a license, US persons likewise must block (freeze) the property of such blocked parties and are restricted from dealing with them, directly or indirectly. With respect to entities in which a designated party has a significant ownership interest that is less than 50 percent, or which a designated party may control by means other than a majority ownership interest, US persons are advised to act with caution as these parties may be designated in the future.

Until further notice, effective March 1, 2014, US authorities also have placed a hold on the issuance of any export licenses authorizing the export or re-export of items to Russia that require such licenses, such as items that relate to short supply, chemical and biological weapons, national security, missile technology and for certain crime control purposes.⁴ On April 28, 2014, they announced that they would deny any pending applications to export or re-export any high technology item subject to the Export Administration Regulations (EAR) to Russia or Crimea that contribute to Russia’s military capabilities, and that existing licenses meeting these conditions also would be revoked.

On April 11, 2014, US authorities added Chernomorneftgaz to the Entity List in response to Russian expropriation of the company, and on April 28, they added 13 additional companies to the Entity List.⁵ 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 such companies, with a presumption of denial. This includes most US-origin products, as well as some non-US made items that incorporate greater than de minimis US-origin content and items that are the direct product of certain US-origin technology.

The State Department has taken the same action in connection with exports of defense articles and defense services to Russia. On March 27, 2014, it placed a hold on all pending export license applications for export to Russia. Effective April 28, 2014, the State Department also announced it would deny any pending applications for export or re-export of any high technology defense articles or services regulated under the US Munitions List (USML) to Russia or Crimea that contribute to Russia’s military capabilities, and that existing licenses that meet these conditions also would be revoked.

In parallel with the US sanctions, the EU has imposed sanctions on 48 individuals from Russia and Crimea.⁶ These sanctions include an asset freeze, as well as an entry and transit ban.⁷ The EU has further imposed a separate asset freeze on 22 individuals in relation to alleged misappropriation of Ukrainian state funds and human rights violations in Ukraine.⁸ There are a few matches between the names featured on the US sanctions list and on the EU sanctions lists, but the EU sanctions are so far relatively narrow; the main difference compared to US sanctions is that the EU has not yet designated any entities and the currently designated persons mostly consist of politicians and military officers.

As a result of the asset freeze, all funds and economic resources belonging to, or controlled by, these EU-designated persons must be frozen. Furthermore, no funds or economic resources may be made available - either directly or indirectly - to or for the benefit of these persons. This means, for example, that funds or economic resources cannot be made available through persons or entities owned or controlled by designated parties.⁹ In other words, if there is EU jurisdiction, one cannot as a general rule do business with these individuals, or legal persons, entities or bodies associated with them.

The concepts “funds” and “economic resources” are interpreted very broadly in the EU to include anything that can be used to obtain funds, goods or services.

In addition, while all EU Member States have agreed to suspend export licences on equipment destined for Ukraine that might be used for internal repression and to “reassess” export licences for military equipment in this context,¹⁰ certain EU Member States have individually imposed further restrictions in response to the Ukraine crisis. On March 18, 2014, the UK announced that it had suspended all existing and pending licences covering export to Russia of military and dual-use items destined for units of the Russian armed forces, or other state agencies, which

4 This action was introduced by the US Commerce Department’s Bureau of Industry and Security (“BIS”).

5 This action was taken by BIS. Chernomorneftgaz and the 13 additional entities also were included in the April 11 and April 28 designations.

6 See Regulation 269/2014 at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:078:0006:0015:EN:PDF>. The list identifying designated parties is featured in Annex I. See also Implementing Regulation 284/2014 at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:086:0027:0029:EN:PDF>. and Implementing Regulation 433/2014 at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2014_126_R_0002&from=EN. The lists identifying designated parties are featured in the Annexes to these Regulations.

7 See Council Decision 2014/145/CFSP, Article 1, at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0145&from=EN>.

8 See Regulation 208/2014 at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0208&from=EN>. The list identifying designated parties is featured in Annex I. See also Implementing Regulation 381/2014 at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0381&from=EN>. The list identifying designated parties is featured in Annex I, while certain amendments to entries for previously listed parties are specified in Annex II.

9 Council guidelines provide further clarification as regards the specific terms of making funds and economic resources “indirectly” available through persons or entities owned or controlled by the listed parties, referring to factual elements such as shareholdings, participation in the decision-making process, etc. See <http://register.consilium.europa.eu/doc/srv?!=EN&t=PDF&gc=true&sc=false&f=ST%209068%202013%20INIT>.

10 See http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/141110.pdf.

could be or are being deployed against Ukraine.¹¹ This licensing suspension also covers exports of items destined for third countries for incorporation into equipment for subsequent export to Russia where there is a clear risk that the end product will be used against Ukraine. The UK has also encouraged other European countries to take similar action. In fact, there have been recent reports that Germany has blocked certain arms exports to Russia as well.¹²

C. Are there any exceptions or carve outs?

In the US, in limited circumstances, US authorities might grant a license authorizing a party to engage in certain activities that otherwise would be prohibited.¹³ Possible examples include authorizations to wind down transactions with designated parties pursuant to contractual commitments entered into prior to designation. OFAC also potentially could authorize companies to engage in otherwise prohibited payments that involve certain products, e.g., food, medicine, or humanitarian goods. The US may issue guidance on exceptions. Designated parties also can submit a written request to US authorities to be “delisted.”¹⁴

Under the EU sanctions, the competent authorities of the EU Member States can authorize derogations from asset freeze measures in certain specified, limited circumstances. For example, derogation from the asset freeze could be allowed if payments are intended exclusively for the payment of fees or service charges for routine holding or maintenance of frozen funds or economic resources, or where a payment by a designated party is due under a contract that pre-dates the asset freeze, provided the payment does not benefit that designated party. Furthermore, the asset freeze will not prevent the crediting of frozen accounts by financial or credit institutions that receive funds from third parties, or the addition of interest or other earnings to frozen accounts.¹⁵

D. What are the penalties for violating sanctions?

US penalties for violations of the sanctions can be severe, including substantial civil and criminal fines and imprisonment. The Executive Orders also establish that the provision of material or technological support for, or goods or services to, designated persons is a criterion for potential future designation.

In the EU, the competent authorities of the EU Member States are responsible for implementation and enforcement of such sanctions policy.¹⁶ All Member States enforce EU sanctions through criminal law, but the precise scope of penalties

(including fines and imprisonment) can therefore vary from one Member State to another.

II. What the sanctions mean for your company

A. Do the sanctions apply to your company?

With respect to US sanctions, first you must determine if you are a US Person. The sanctions apply to US Persons, which include:

- Individuals and entities located in the United States;
- US citizens and green card holders, wherever located;
- US incorporated companies, including foreign branches; and
- US subsidiaries of non-US companies.

US persons are prohibited from dealing, directly or indirectly, with designated parties or blocked persons.

Second, you must determine on a transaction-by-transaction basis (for all activities, including, but not limited to, import and/or export transactions, sales, purchasing, licensing, borrowing and acquisitions) whether a transaction with a US nexus (denominated in US dollars or involving US persons) also involves blocked parties. Under certain circumstances, US sanctions can reach non-US persons involved in transactions with blocked persons if the transaction occurs in the United States or has a sufficient US nexus. Moreover, even where there is no apparent US nexus, you should exercise extreme caution engaging in transactions with blocked persons given the fluid and evolving nature of the sanctions and the fact that the US has warned that it may designate additional parties, including those found to have provided support to designated parties. The Executive Orders specifically identify the provision of support or other services to designated parties as a basis for potential future designations.

In addition, the US policy announced, as of March 1st, regarding the suspension of export licenses for exports or re-exports to Russia impacts not only US businesses engaged in exports to Russia, but also non-US companies engaged in exports to Russia from third countries of products that are of US origin and that require BIS licenses. This can include products with US origin content or made as the direct product of US origin technology. The addition of 14 companies to the Entity List also impacts US and non-US companies by imposing a license requirement for exports from the US or re-exports of US origin content or technology from third countries to these companies.

EU sanctions are only applicable to activities falling under EU jurisdiction, i.e. when there is an EU nexus linking restricted activities to the EU. As a general

11 See <http://blogs.bis.gov.uk/exportcontrol/uncategorized/notice-to-exporters-201406-uk-suspends-all-licences-and-licence-applications-for-export-to-russian-military-that-could-be-used-against-ukraine/>.

12 See <http://www.telegraph.co.uk/news/worldnews/europe/germany/10785658/Germany-halts-weapons-exports-to-Russia.html>.

13 The relevant principal US authority is the US Department of the Treasury's Office of Foreign Assets Control ("OFAC").

14 OFAC is responsible for delisting.

15 See Articles 4 – 7 of Regulation 269/2014.

16 See the listing of websites for more information on the EU Member States' competent authorities in this context in Annex II of Regulation 269/2014.

rule, the EU has jurisdiction in the following five situations:

- a) within the EU territory;
- b) on board any aircraft or vessel under EU Member State jurisdiction;
- c) to nationals of EU Member States (even if outside the EU);
- d) to entities incorporated or constituted under the law of a Member State; and
- e) to entities in respect of any business done in whole or in part within the EU.

This means that non-EU companies can potentially be covered by the EU's sanctions, depending on the circumstances under which they perform business activities in the EU. For example, in such a context there will generally be EU jurisdiction when Member State nationals are acting as employees, or when a particular (restricted) transaction relates to the company's business within the EU.

B. What steps can be taken to comply with the sanctions and limit exposure?

Key steps to manage risk under the US and EU sanctions now in place include:

- Screening parties to transactions (e.g., customers, suppliers, distributors, transportation companies, banks) that involve a Russian or Ukrainian element against comprehensive designated party lists;
- Performing due diligence with respect to ownership of parties to transactions, including beneficial ownership;
- Performing heightened due diligence with respect to transactions where there are red flags or otherwise may be a reason to believe a designated entity is benefiting from a transaction that on its face does not involve one;
- Considering additional contractual language and other protections in contracts and transaction documents to cover current or future Ukraine-related sanctions;
- Reviewing and ensuring that compliance programs are robust and effective, with adequate procedures and training programs, and are updated to account for the Ukraine-related sanctions;
- Monitoring and anticipating possible future sanctions; and
- Seeking OFAC or other authorization, wherever necessary.

III. How the sanctions scenario might change in the future

The current sanctions are fluid and volatile, and are subject to unforeseeable political and economic developments. For example, in the US, one Executive Order already authorizes future sanctions on entities operating in the financial services, energy, metals and mining, engineering, and/or the defense and related materiel sectors of the Russian Federation. In addition, the legislation passed on April 3, 2014 authorizes future sanctions on close associates or family members of Russian Government officials.

With respect to EU sanctions in response to the Crimea crisis, the EU Council recently confirmed that work is underway on a proposal for economic, trade and financial sanctions which would be applied if further steps are made by Russia to destabilize the situation,¹⁷ but the details and timing of such additional restrictions are at this stage unclear. Furthermore, it has been reported that the EU will in the near future impose economic and trade restrictions against Crimea itself which would essentially treat it as an occupied territory, as a legal consequence of Russia's annexation.¹⁸

On April 17, 2014, the US, EU, Ukraine, and Russia engaged in diplomatic talks in Geneva and agreed on initial concrete steps to de-escalate the crisis. On April 28, the G-7 issued a statement promising further sanctions in light of the absence of Russian steps to implement the agreement reached in Geneva.¹⁹ The additional EU and US designations and export restrictions were announced following the G-7 statement. There continues to be talk of potential new sanctions on the horizon.

Taking a historical look at sanctions imposed in past crises may suggest alternative future scenarios, assuming there is no definitive diplomatic solution to this crisis:

- Current sanctions could continue in place largely as is for an extended period;
- Sanctions could become progressively tougher and broader in scope but still allow some commercial activity (which EU sanctions normally do in any event, as there is a tendency to avoid comprehensive country-wide sanctions measures);

17 See http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/142223.pdf.

18 See <http://www.euractiv.com/sections/europes-east/eus-crimea-sanctions-modelled-occupied-palestinian-territories-301573>.

19 See http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/142405.pdf.

- Expanded sanctions could include restrictions on additional Russian government entities (e.g., police/military, state-owned banks) or on close associates or family members of Russian Government officials, restrictions on individuals or entities in certain sectors (e.g., financial services, energy, metals and mining, engineering, and/or defense), limitations on government procurement opportunities, and further restrictions on export licensing;
- From the US perspective, extraterritorial measures or “secondary sanctions” also could be imposed that, for example, would require no US nexus as was done in the case of Iran (e.g., prohibiting access to the US commercial and financial systems to non-US entities that engage in sanctionable conduct);
- Comprehensive country-wide sanctions that would restrict all commercial and financial activity relating to Russia (an unlikely scenario unless events escalate markedly); and
- Strengthening of sanctions by the US and EU would also likely lead to strengthening of sanctions by Russia.

Richard Burke

Partner, Washington DC

T +1 202 626 3687

F +1 202 639 9355

rburke@whitecase.com

Nicole Erb

Partner, Washington DC

T +1 202 626 3694

F +1 202 639 9355

nerb@whitecase.com

James Killick

Partner, Brussels

T +32 2 239 25 52

F +32 2 219 16 26

jkillick@whitecase.com

Igor Ostapets

Partner, Moscow

T +7 495 787 3019

F +7 495 787 3001

iostapets@whitecase.com

Key Resources

For additional information related to the US and EU sanctions see

www.whitecase.com/ukraine-news-update

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