# Client Alert

**September 16, 2014**

# Ratcheting up the Pressure: Reinforced Ukraine-related Sanctions on Russia

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On September 12, 2014, the United States ("U.S.") and European Union ("EU") both announced expanded sanctions related to Russia and Ukraine. These measures seek to increase pressure on the Russian Government to stop threatening the territorial integrity of Ukraine. In general, the specific sanctions (i) target specific entities and individuals, (ii) limit access to financial markets, and (iii) prohibit certain oil related exports and activities.

## U.S. SANCTIONS

As a result of Russia's annexation of Crimea and destabilization of Ukraine, in March 2014, President Obama issued a series of Executive Orders ("EOs") authorizing U.S. Government sanctions against individuals and entities ("persons") that have contributed to the conflict in Ukraine. Pursuant to the EOs, the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") has implemented the Ukraine-related sanctions regime that (i) designates Russian and Ukrainian persons as Specially Designated Nationals and Blocked Persons ("SDNs") and (ii) imposes targeted sanctions against entities in the Russian financial services, energy and defense sectors (the "Sectoral Sanctions"). In addition, on August 6, 2014, the U.S. Commerce Department's Bureau of Industry and Security ("BIS") imposed controls on the export of certain items to Russia for use in the oil and gas sectors.

U.S. persons must be particularly diligent to avoid engaging in transactions that involve SDNs, that are prohibited by the Sectoral Sanctions, or involve the export of controlled items to Russia.

### Specially Designated Nationals

Since March 2014, OFAC has added numerous persons to the SDN list under authority of the Ukraine-related EOs. As with all SDN designations, all property and interests in property of Ukraine sanctions-related SDNs within the possession or control of a U.S. person are blocked and may not be transferred, paid, exported, withdrawn, or otherwise dealt in. This prohibition includes the making of any contribution or provision of funds, goods, or services by, to, or for the benefit of any SDN and the receipt of any contribution or provision of funds, goods, or services from any SDN. On September 12, 2014, OFAC designated several new SDNs, including five Russian state-owned defense-technology firms, and OFAC will likely designate additional Russian and Ukrainian SDNs as events develop further.

It is important to note that an entity in which one or more SDNs owns a 50% or greater interest is deemed to be an SDN, even if such entity is not specifically identified on the SDN list. OFAC also advises parties to be cautious regarding transactions with entities in which SDNs have a significant, but less than 50%, interest because these entities may be the subject of future sanctions.

**Sectoral Sanctions Identifications List**

The U.S. Ukraine-related sanctions established a legal framework for a novel OFAC sanctions program: they authorize the imposition of sanctions on persons active in certain sectors of the Russian economy, specifically the financial services, energy, metals and mining, engineering, and defense and related materiel sectors. On July 16, 2014, OFAC issued its initial Sectoral Sanctions Identifications ("SSI") list, and since then, has periodically added entities to this list. On September 12, 2014, OFAC significantly expanded the list, adding several larger financial institutions, including Sberbank of Russia, Russia's largest bank and in the energy industry, Gazprom, a global energy company. At present, the SSI list includes entities in the financial services, energy and defense sectors.

With respect to the financial services SSI list entities, U.S. persons are prohibited from transacting in, providing financing for, or otherwise dealing in new debt of longer than 30 days maturity (originally 90 days maturity under the initial sanctions) or new equity of such SSI entities. The same long-term debt prohibition applies to the energy sector SSI list entities for debt of longer than 90 days maturity, but not the new equity prohibition. With respect to the defense and related materiel sector of Russia, there is also a long-term debt prohibition for debt of longer than 30 days maturity. Any entity 50% or more owned by an entity on the SSI list is also deemed to be subject to the Sectoral Sanctions.

The SSI list is separate from the SDN list. The OFAC press release announcing the SSI list makes clear that "[a]ll other transactions with these persons or involving any property in which one or more of these persons has an interest are permitted, provided such transactions do not otherwise involve [an SDN]." For example, transactions involving old debt, short-term debt and correspondent bank account transactions with SSI list entities are permitted. Moreover, OFAC issued a general license permitting U.S. persons to engage in transactions involving a derivative product where its value is linked to an underlying asset subject to Sectoral Sanctions. However, an entity on the SSI list may also be on the SDN list, and in those cases, U.S. persons cannot engage in any transaction with the SDN or any 50% or more controlled subsidiary.

**Certain Licensing Requirements for Export Products**

On August 6, 2014, BIS announced a new rule imposing export license requirements on certain specifically identified oil and gas related products (such as oil and gas pipes, drilling equipment, pipe and casting, subsea processing equipment, and related software and technology), if the exporter knows (or should have known) that the items are for use, directly or indirectly, in Russian deep-water, Arctic offshore or shale projects, or if the exporter is unable to determine whether the items will be used in such projects. Given the broad scope of this prohibition, it may be difficult for exporters to obtain appropriate use assurances to meet this test. In any event, the BIS rule also states that license requests for the export of such items to Russia will be subject to a "presumption of denial."

**Blanket Prohibition to Export Certain Products to Certain Russian Energy Companies**

The September 12, 2014 OFAC sanctions also prohibit the exportation of goods, services (not including financial services), or technology in support of exploration or production for Russian deep water, Arctic offshore, or shale projects that have the potential to produce oil with respect to certain Russian energy companies including, Gazprom, Gazprom Neft, Lukoil, Surgutneftegas, and Rosneft. U.S. persons have until September 26, 2014, to wind down applicable transactions, but must report such activity to OFAC.

Given the ongoing changes to the Ukraine-related sanctions programs, U.S. persons should have appropriate procedures in place to comply with existing sanctions and monitor developments to ensure ongoing compliance.

EU SANCTIONS

The EU sanctions (referred to as “restrictive measures”) announced on September 12, 2014, expand the prior restrictive measures related to Russia and Ukraine. As a result, numerous persons and companies are subject to restrictive measures such as the freeze of assets and travel bans. In addition, sector-specific restrictions apply which particularly relate to access to the EU capital markets, to the defense industry, and the energy sectors.

**Blocking of Funds and Assets**

The EU sanctions provide for the freezing and recovery of assets of listed persons and entities: the blocking of assets concerns all funds and economic resources belonging to, owned, held or controlled by the listed persons, entities, or bodies associated. In addition, it is prohibited for persons subject to the EU sanctions to make available funds or economic resources to such listed persons, entities or associated bodies: This prohibition is rather broad since it includes the prohibition to make resources indirectly available. Precedents show that this may include business with subsidiaries held by a listed person or entity. Moreover, it is prohibited to participate in any activities circumventing the sanctions.

**Exports of Dual Use Items**

There is a prohibition on the export to Russia of military goods and of dual-use items if those items are or may be intended for military use. As of September 12, 2014, it is also prohibited to sell any dual-use item or to provide financial or technical assistance to certain listed companies, including JSC Sirius, OAO JSC Chemcomposite, and JSC Kalashnikov.

**Russian Oil Industry**

With regard to oil exploration, it is prohibited to provide certain services necessary for deep water and Arctic oil exploration and production or shale oil projects in Russia. Also, sale, supply, transfer, or export of certain listed technologies (e.g., pipes, drilling technology) requires prior authorization by the competent EU Member States’ bodies. Additional restrictions apply with regard to Ukraine (see below).

**Capital Markets**

For certain Russian state-owned banks and companies of the defense and energy industries, the access to the EU’s capital markets has been further reduced. EU nationals and companies are disallowed to provide certain loans and financial instruments to those companies which include, for example, Gazprombank, Gazprom Neft, Rosneft, and Transneft.

**Ukraine Specific Prohibitions**

With regard to the annexation of Crimea and Sevastopol, the EU has set up an additional regime of restrictive measures which have to be taken into consideration when dealing with persons or companies in eastern Ukraine. For example, the EU sanctions prohibit trade with key equipment and technology related to the creation or development of infrastructure for the exploitation of oil, gas, and mineral reserves in Crimea and Sevastopol. The key equipment listed includes line pipes and drilling technology for the oil and gas industry. The prohibited actions also concern the provision of technical assistance or brokering or financial services in relation to trade with such key equipment.

**Scope of EU Sanctions**

The EU sanctions do not only concern EU-based companies as they also apply to companies headquartered outside the EU that have an affiliate incorporated under EU Member State laws or employ EU citizens, or that are carrying out their economic activities in whole or in part within the EU. Any violation of these export restrictions and other restrictive measures may trigger severe administrative fines or even criminal sanctions (including prison). Accordingly, companies doing business in or with Ukraine or Russia should carefully assess whether their dealings and the related financial transactions comply with the restrictions set out by the relevant EU regulations.

**Licensing Policy**

While most of the above-mentioned business activities are strictly prohibited and cannot be cleared, some transactions may still take place upon prior approval, which has to be obtained from the competent EU Member States' authorities. For example, the sale, transfer, or export of certain technologies for the oil industry requires prior authorization. Also, certain financial transactions may be allowed upon approval or require notification only.

## CONCLUSION

The reinforced EU and U.S. sanctions will further impede Russia's struggling economy. Counter-reactions such as import bans for EU products (already in effect) and a potential closure of the airspace above Siberia for EU airlines (threatened potential reaction) could further limit EU companies' business opportunities as is already the case due to the boomerang effects of the EU sanctions regime.

Given the ongoing changes to the Ukraine-related sanctions programs, persons and entities covered by the scope of the applicable sanctions regimes should have appropriate procedures in place to comply with existing sanctions and monitor developments to ensure ongoing compliance.

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