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Special Update

Sanctions

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Overview of the U.S. and EU Sanctions on Russia

Introduction Over the past six months, the United States and the European Union have coordinated efforts through sanctions and trade controls to respond to Russian activity in Crimea and Ukraine. Following a long series of incremental changes to the sanctions and trade controls by the respective government authorities (which are described in detail in our regular client alerts and blogs), this alert provides a summary of the state of U.S. and EU sanctions on Russia as of September 24, 2014.

As described in more detail below, there is a high level of consistency between the sanctions and trade controls to include a similar approach to: asset freezes; controls on financing directed at the oil, gas, energy, and defense industries; restrictions on access to capital markets; controls on goods and services for the Russian military and other military end users in Russia; and controls on certain dual use items. However, there continue to be some nuanced differences between the two approaches, including variance in the persons subject to asset blocks, differences on the controls applicable to imports and investments in infrastructure, and how the specific prohibitions are implemented by the respective government agencies.

United States The U.S. sanctions on Russia are focused on the financial services, energy, and defense industries. The sanctions contain a variety of targeted prohibitions that have increasingly expanded the scope of the sanctions program, to include:

- Designating or blocking certain Russian individuals and entities, and an important change in the Office of Foreign Assets Control ("OFAC") policy on entities owned by blocked persons

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- Limiting the availability of debt financing for certain Russian financial institutions
- Prohibiting the provision of goods, services, and technology in support of certain activities relating to the exploration or production of oil or gas in Russia, its claimed maritime area, or "extending from its territory"
- Restrictions on the supply of certain items (a) to the Russian military or other military end-users in Russia; and (b) for use in oil or gas exploration or production in Russia, including Arctic offshore locations or shale formations
- Restrictive licensing policies for export activities involving Russian-made defense articles (including spacecraft) and defense articles intended for end-use in Russia

The sanctions include both economic measures administered by OFAC and export controls administered by the U.S. Department of Commerce, Bureau of Industry and Security ("BIS"), and the U.S. Department of State, Directorate of Defense Trade Controls ("DDTC").

The current status of these controls is addressed in more detail below:

1. **OFAC Sanctions** On July 16, 2014 and September 12, 2014, OFAC issued a series of Directives imposing targeted sanctions upon key elements of the Russian economy. Each Directive governs activities between U.S. persons (to include any person within the United States) and those persons listed on the Sectoral Sanctions Identifications ("SSI") List. The SSI List is organized according to the four Directives. *See* http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/ssi_list.aspx. Unlike the Specially Designated Nationals ("SDN") List, which includes blocked persons and prohibits substantially all activity with so-called SDNs, the SSI List designations result in prohibitions that are limited to those activities targeted by the Directives.

   As an aside, OFAC also recently revised its policy on entities that are owned by SDNs and SSI List persons to extend the designations to entities owned 50 percent or more by one or more persons on the SDN or SSI List.

   The four Directives are as follows:

   - **Directive 1** targets the financial services sector of the Russian economy. This directive prohibits engaging in transactions in, providing financing for, or otherwise dealing in new debt with a maturity of longer than 30 days, or equity for persons identified on the SSI List under Directive 1.
   - **Directive 2** targets Russia's energy sector of the Russian economy by prohibiting transactions in, provision of financing for, and other dealings in new debt with a maturity of longer than 90 days for persons identified on the SSI List under Directive 2. equity for persons identified on the SSI List under Directive 1.

- **Directive 3** targets the Russian defense and related material sector by prohibiting all transactions in, provision of financing for, and other dealings in new debt of longer than 30 days for persons identified on the SSI List under Directive 3.

- **Directive 4** expands on the sanctions targeting the Russian energy sector by prohibiting "the provision, exportation, or reexportation, directly or indirectly, of goods, services (except for financial services), or technology in support of exploration or production for deepwater, Arctic offshore, or shale projects that have the potential to produce oil in the Russian Federation, or in maritime area claimed by the Russian Federation and extending from its territory" that involve any person identified on the SSI List under Directive OFAC has also issued General Licenses authorizing certain transactions relating to derivative products (relevant to SSI List entities under Directives 1-3) and a short wind-down period (relevant to Directive 4).

2. **Commercial and Dual-Use Controls (the Export Administration Regulations)** On August 6, 2014, BIS amended the Export Administration Regulations ("EAR") to include the "Russian Industry Sector Sanctions" as section 746.5. These sanctions impose a license requirement for the export to Russia of certain items if the exporter, reexporter, or transferor knows that the item "will be used directly or indirectly in exploration for, or production of, oil or gas in Russian deepwater (greater than 500 feet) or Arctic offshore locations or shale formations in Russia, or are unable to determine whether the item will be used in such projects." The items subject to this license requirement include items classified under the following Commerce Control List ECCNs: 0A998, 1C992, 3A229, 3A231, 3A232, 6A991, 8A992, 8D999, as well as EAR99 items identified in Supplement No. 2 to Part 746. BIS also established a policy of denial for such license applications. BIS further imposed a license requirement (subject to a policy of denial) for all exports, reexports, or transfers to Russia of items subject to the EAR if intended, in whole or in part, for a military end-use or military end-user in Russia.

3. **Military/Defense Controls (the International Traffic in Arms Regulations)** On March 27, 2014, DDTC placed a hold on the issuance of International Traffic in Arms Regulations ("ITAR") licenses for the export of defense articles and defense services to Russia. Subsequently, on April 28, 2014, DDTC changed its hold on licenses to a policy of denial for defense articles or defense services to Russia or occupied Crimea. DDTC also began the process of revoking existing licenses for defense articles and services. DDTC is currently reviewing defense article export licenses on a case-by-case basis to determine the export's contribution to Russia's military.

European Union As tensions rose in the Ukraine and Crimea, and in the absence of de-escalatory steps by the Russian Federation, the EU began imposing sanctions in March 2014. As with the sanctions imposed by the United States, these have expanded in scope to include:

- Sanctions targeting individuals and entities through travel bans and asset freezes
- Measures dealing with access to the capital markets for specified financial and defense institutions
- Restrictions on the export of dual-use goods and technologies
- Restrictions on dealing with technologies listed on the Common Military List
- Restrictions on dealing with goods and services related to the oil industry

Below is a summary of the current restrictions:

1. **Travel Bans and Asset Freezes** In March, the EU introduced measures to restrict the travel and freeze the assets of individuals and entities responsible for actions undermining or threatening the sovereignty of the Ukraine (by Council Regulation (EU) No 269/2014). At that time, 21 names were added to the list. The list has twice since been updated, to include an additional 36 names (by Council Implementing Regulation (EU) No 284/2014 and Council Implementing Regulation (EU) No 961/2014). The individuals subject to restrictions under the U.S. and EU regimes have not always been consistent, and so it is necessary to separately track the individuals restricted.

2. **Access to Capital Markets and Loans** As in the United States, the EU has imposed restrictions on financial dealings with certain named entities operating in the Russian financial and defense industries. While these restrictions fall short of an absolute prohibition on dealings with such entities, they do place substantial limitations on transactions involving transferable securities and money market instruments when issued by them.

   "Transferable securities" is widely defined and includes shares in companies; other securities equivalent to shares in companies, partnerships or other entities; and bonds or other forms of securitized debt, such as depositary receipts. In addition, any securities giving the right to acquire or sell any such instrument are covered. Similarly, "money market instruments" includes classes of instruments that are normally dealt in on the money market, particularly treasury bills, certificates of deposit and commercial papers.

   The first restrictions targeting financial institutions were introduced in July. At that time, it was prohibited to deal with transferable securities and money-market instruments with a maturity exceeding 90 days when issued by the named institutions set out in our client alert available here.

However, this restriction has recently been tightened so that in relation to any transferable securities or money-market instruments issued after September 12, 2014, the maximum maturity period is now 30 days.

A mirroring provision was introduced in September dealing with such securities or instruments with a maturity exceeding 30 days when issued by certain defense companies and crude oil and petroleum transport companies. The entities covered by this prohibition are set out fully in our client alert available here.

In addition to the above, it is prohibited to make available any new loans or credit exceeding 30 days to any of the entities covered by the restrictions outlined above.

3. **Dual-use Goods and Technologies** In July, restrictions were introduced on the export or sale of certain dual-use goods and technologies, and the provision of related services to any entity or body in Russia, or for use in Russia, if those items are or may be intended, in part or otherwise, for military use or for a military end-user (by Council Regulation (EU) No 833/2014). However, prior authorization can be sought from competent authorities in limited cases where authorities have no reasonable grounds to believe that the end-user might be a military end-user, or that the goods might have a military end-use. In addition, and with no provision for gaining prior authorization, brokering services related to such dual-use goods and technology, and the provision of financing or financial assistance, are prohibited where the items are intended for military use or a military end-user.

   In September 2014, a further restriction was imposed (by Council Regulation (EU) No 960/2014) on the export or sale of certain dual-use goods and technologies, or the provision of brokering or other services, or the arranging of finance or financial assistance for such goods or services, when provided to specific entities listed in our client alert available here. As a result, any entity supplying such goods and technologies should carefully consider the existing sanctions to ensure that they are in compliance with their provisions.

4. **The Common Military List** In July, the EU imposed a restriction on providing technical assistance or financing in relation to goods and technologies listed in the Common Military List. This restriction applies to any dealings with a natural or legal person, entity or body in Russia, or for use in Russia.

5. **The Oil Industry** There are two layers of restrictions in relation to the oil industry in Russia. In July, restrictions were introduced on the export or sale of certain technologies suited to the oil industry for use in deep water oil exploration and production, Arctic oil exploration and production, or shale oil projects in Russia. This restriction applies to any goods, whether or not

originating in the EU, when supplied to any natural or legal person, entity or body in Russia, or, if supplied to any other country, if such equipment or technology is for use in Russia. A prior authorization is required to undertake any of these activities, as in the United States, and shall not be granted in the event that a competent authority has reasonable grounds to determine that such technologies are for use in projects of the type outlined above. Restrictions are also imposed on the provision of technical assistance, brokering services, or financing or financial assistance, in relation to these technologies.

In September 2014, the EU introduced a further prohibition on providing services, including drilling, well testing, logging and completion services, and the supply of specialized floating vessels for projects of the above types in Russia. This is an absolute prohibition, with no ability to apply for a prior authorization. However, a grace period was given for contracts concluded up to September 12, 2014.

These restrictions are substantially similar to those implemented by the United States under Directive 4, outlined above.