

Morgan Lewis

UPDATE ON US AND EU RUSSIA SANCTIONS – ENERGY SECTOR FOCUS



as of 18 September 2017

Jon Hines, Partner – Moscow Office
Bruce Johnston, Partner – London Office
Carl Valenstein, Partner – Boston Office
Brian Zimble, Partner – Moscow/D.C. Offices
Louis Rothberg, Of Counsel – D.C. Office
Andrei Ignatenko, Associate – Moscow Office

CONTENTS

- What's Newest..... 3
- Basic Framework..... 9
- US Sectoral Sanctions – OFAC.....11
- US Sectoral Sanctions – BIS.....17
- US Crimea Sanctions..... 22
- US Direct Sanctions – SDNs..... 23
- US Ukraine Freedom Support Act..... 27
- EU Sectoral Sanctions..... 29
- EU Direct Sanctions (SDN-like)..... 41

What's Newest

- **New US Sanctions Legislation**

- *Overview*

- President Trump signed this into law on 2 August (after its passage through both Houses of Congress by near-unanimous vote)
- This is the “Countering Russian Influence in Europe and Eurasia Act of 2017” (the “new Act”)
 - ❖ part of a larger law that also includes Iran and North Korea sanctions
 - ❖ full text is at <https://www.whitehouse.gov/legislation/hr-3364-countering-americas-adversaries-through-sanctions-act> – the Russia sanctions section spans sections 216-292
 - ❖ ... the N. Korea part is aimed primarily at foreign companies/banks (featuring de facto focus on Chinese, Russian, etc.) doing various types of business directly or indirectly there (*note that Independent Oil Co – “NNK” is now an SDN in this connection... see slide 24*); there are also serious new Iran-related secondary sanctions

(and have in mind also the newly tightened anti-Venezuela sanctions – can affect some Russian companies – but Venezuela, N. Korea, Iran are not further covered here)

- Broadens / toughens the pre-existing sanctions as contained in six Executive Orders, the Ukraine Freedom Support Act of 2014 (the “UFSA”) and another 2014 law in support of Ukraine
- Dramatically widens gaps between US and EU sanctions against Russia... despite the new Act’s intro statement that the President “should continue to uphold and seek unity with European and other key partners” on Russia sanctions
- See the President’s two signing statements (available on White House website) – which
 - ❖ criticize the new Act’s incursion onto Executive Branch prerogatives, and
 - ❖ emphasize the importance of coordination with allied countries and of not harming US business

What's Newest (cont'd)

– *Basic Content*

- “Codification” by statute of the existing blacklist (SDN) and sectoral (SSI) sanctions enacted by a series of Executive Orders since 2014 against Russia
 - ❖ which will make it harder for President Trump (and his successors) to narrow or otherwise loosen any of these sanctions by executive action
 - ❖ but see the President’s signing statements, signaling his intent to exercise appropriate discretion in any event
- Tightens existing OFAC Directives 1, 2 and 4 application (*this is for US persons*)
 - ❖ *Directive 1*: permissible “new debt” of the designated Russian banks is reduced from max. 30 to 14 days
 - ❖ *Directive 2*: permissible new debt of the designated Russian energy companies is reduced from max. 90 to 60 days
 - ❖ *Directive 4*: the prohibition on goods/services/tech/software involvement in deepwater, Arctic offshore or shale projects is expanded from Russia to worldwide
 - ✓ but only for “new” projects (there are interpretation issues here – for OFAC)
 - ✓ if one of the designated Russian energy companies has at least a 33% interest
 - ✓ (and might conceivably be extended by BIS — to cover export/reexport of US goods/technology worldwide)
 - ❖ All to be triggered by OFAC amendment of the relevant directive within 60/90 days after 2 August, and then 60/90 day delayed effectiveness

What's Newest (cont'd)

- Expansion of Executive Order 13362's potential industry coverage (beyond financial services, energy, engineering/defense-related)
 - ❖ to state-owned (i) railway (= RZhD, the Russian State Railway), and (ii) mining & metals companies (e.g., state-owned uranium producer?)
 - ❖ but shipping industry is left off this expanded list (was in early Senate version); and nuclear power industry also doesn't appear despite initial consideration of including it
 - ❖ in any event, any such new sanctions expansion is discretionary with Treasury Dep't
- Requiring *review and approval by Congress* before the President can terminate or waive existing sanctions (or grant any non-routine-type license that "significantly alters" US foreign policy re Russia)
- Creating new *discretionary* power for the President, *in coordination with US allies*, to impose various possible sanctions on US *or non-US* companies or individuals that invest or are otherwise involved substantially (low monetary thresholds are given) in the construction (or modernization, repair) of *energy export pipelines by Russia*
 - ❖ the underlined language was added at late stage, apparently per European lobbying
 - ❖ but there is a separate statement of US policy "to continue to oppose the Nordstream 2 pipeline" ... and other pipelines might be touched as well
 - ❖ and some signs already that the mere enactment, even without any presidential movement to impose it, has complicating effect on Nordstream 2 financing

What's Newest (cont'd)

- *Requiring* the President to impose sanctions (again from some menus of possibilities – essentially involving penalties re business with/in the US) in various contexts (upon findings, with some carve-outs / waiver possibilities) including against:
 - ❖ *non-US* companies and individuals that invest in deepwater, Arctic offshore or shale projects in Russia (apparently whether or not one of the Directive 4 Russian companies is involved)
 - ❖ *Russian and other non-US financial institutions* that engage in “significant transactions” involving Russia deepwater, Arctic offshore or shale projects (again, seems whether or not...)
 - ❖ *US or non-US* companies and individuals that make or facilitate investments into *privatization* of Russian state-owned companies (of \$10M, or combination \$1M+ bites for \$10M total in a year) where the process “unjustly benefits” RFG officials or their close associates / family (*this may well be hard to assess*)
 - ❖ *non-US companies* and individuals that knowingly (*this is the vaguely-worded and possibly quite broad-sweep section 228, which is causing great concern*)
 - ✓ materially violate, attempt or conspire to violate or cause a violation of any Russia sanction
 - ✓ facilitate “significant transactions” (including “deceptive or structured transactions”) for or on behalf of any person that is subject to a Russian sanction – or a child, spouse, parent or sibling thereof

(This second prong could be read to sweep broadly, beyond SDNs to SSI entities – but see next slide)

What's Newest (cont'd)

- Thus, a series of possible “secondary sanctions” (i.e., aimed at non-US persons) is to be introduced
 - ❖ apparently whether or not there is any US nexus (but would seem perverse to penalize any foreigners’ activities – i.e., some dealings with mere SSIs – that aren’t prohibited for US persons)
 - ❖ and the above second-prong extension to family members would suggest an intended SDNs focus?
 - ❖ and query whether could be applied against *Russian* companies/banks re their own (or their affiliates’ or another Russian company’s) projects (generally such secondary sanctions have not been so applied – but the possibility can’t be excluded per the pure statutory wording)
 - ❖ awaits regulatory clarification by OFAC – none yet ... as of 18 September (early Oct. deadline)
- Exemption for Russian suppliers in connection with NASA or DoD space launches
- Possible more sanctions to come: Executive Branch is directed to prepare reports for Congress on
 - ❖ Russian senior political figures and oligarchs and their “closeness to the Russian regime” and their net worth / sources of income, exposure to and impact on US/allied economies, etc.
 - ❖ the effects of potentially expanding the Directive 1 debt sanction “to include Russian sovereign debt and the full range of derivative products”
 - ❖ US, and coordinated with private sector and allied countries, efforts to combat “illicit finance” relating to Russia, and “identifying foreign sanctions evaders” and loopholes within other countries’ sanctions regimes

What's Newest (cont'd)

- **Other Recent Developments**

- OFAC's 20 July imposition of \$2 million penalty on ExxonMobil
 - For claimed violation in allowing Rosneft's CEO Mr. Sechin (an SDN) to sign for Rosneft various JV-related agreements in May 2014
 - ... and ExxonMobil's 21 July initiation of federal court challenge against this
- The still-unfolding July scandal involving Siemens gas turbines
 - Assembled at their Russian JV plant for use in Russia, and then modified and redirected to a Crimea power plant (which is prohibited by EU sanctions)
 - Evidently without Siemens' knowledge, and despite its strict compliance measures
 - EU has named a few involved Russian companies/individuals to its blacklist (SDN-type) sanctions list in this connection
- Reported USG expressed opposition to a Japanese consortium energy project
 - Intended JV participation in development of Rosneft's Central Tatarsky block offshore Sakhalin (which is partially >500 feet – i.e., deepwater) ... viewed as "backfilling"
 - Reminiscent of situation preceding BIS designation of Gazprom's South Kirinsky block a few years ago – might happen again

- **EU – extension of its Russia sanctions; reaction to US new Act**

- The sectoral sanctions were extended to 31 January 2018
- And the blacklist sanctions, for now to 15 March 2018 (done on 14 Sept.)
- But threatened EU blocking or other retaliatory measures if the US broad-reach new Act is applied against an EU company

Basic Framework

• United States

- Treasury Dep't (*Office of Foreign Assets Control – OFAC*) "sectoral" sanction directives, amended to date – most recently 20 June 2017 (based on EO 13662 from March 2014)
 - *generally applies only to "US persons" and any persons/entities in the US (citizens / green card holders, US companies, branches of foreign companies)*
 - but may also be applied to non-US persons anywhere, for activity that causes (i) US persons to violate or (ii) a violation to occur within the US – e.g., the large fines levied against certain European banks for such (involving Iran, Syria, Sudan sanctions, etc.), *and the recent Zarrab case*
 - and SDN designations / sanctions also administered by OFAC
- Commerce Dep't (*Bureau of Industry and Security – BIS*) export restrictions – 15 CFR §746.5, "Russian Industry Sector Sanctions", amended to date – most recent 7 Sept. 2016
 - applies to activities of any "US person" or within the US
 - and also to US goods, technology etc. or with sufficient US content, wherever located
- Ukraine Freedom Support Act – UFSA (Dec. 2014 ... *and as just materially amended*)
 - establishes presidential authority, and in some cases obligation (with exceptions), to impose a newly expanded range of so-called "secondary" commercial sanctions – apply mostly to foreign, not US, companies
 - hasn't been applied at all to date, by Presidents Obama or Trump – but might happen soon
- Crimea-focused Executive Order (EO) 13685 of 19 Dec. 2014 ... and Crimea-related SDNs
 - administered by OFAC, supplemented most recently 20 June 2017
 - and related BIS implementing rules of 29 Jan. 2015
- And now the new Act, which would fortify much of the above

Basic Framework (*cont'd*)

- **European Union**

- EU Council Regulation No. 833/2014 of 31 July 2014 – as amended by Reg. Nos. 960/2014 of 8 Sept. 2014, 1290/2014 of 4 Dec. 2014, and 2015/1797 of 7 Oct. 2015
 - applies to EU nationals and companies
 - or anything happening in whole or part within EU territory
 - or involving an EU-registered aircraft / vessel
- Commission Guidance Notice (16 Dec. 2014, as amended 25 Sept. 2015) on application of certain provisions
- Currently in effect to 31 Jan. 2018 (extended as of 28 June 2017)
- and, re Crimea
 - EU Council Regulation No. 692/2014 of 23 June 2014 – as amended by Reg. No. 825/2014 of 30 July 2014, and Reg. No. 1351/2014 of 19 Dec. 2014
 - hits investments in oil & gas and other mineral resources E&P, power, transport, telecoms
 - currently in effect to 23 June 2018 (extended as of 19 June 2017)
- and SDN-like “blacklist” Reg. No. 269/2014 of 17 March 2014 (and updates since then) – currently in effect to 15 March 2018 (last extended 14 Sept. 2017)

US Sectoral Sanctions – OFAC

Finance / Capital Markets

- The OFAC SSI sanctions prohibit without license:
 - new debt financing with maturity >14 days (*just revised down from >30 days*), or new equity financing, for these designated entities or their subs (50%-or-more owned), and transactions with or dealing in such debt or equity (Directive 1)
 - *Bank of Moscow* (note: doesn't exist as entity anymore – consolidated within VTB now)
 - *Gazprombank*
 - *Russian Agricultural Bank (Rosselkhozbank)*
 - *Sberbank* (note – one limited license given)
 - *VEB*
 - *VTB*

(except depositary receipts based on pre-existing shares – per FAQ 391)

- and note OFAC's expanded bank SSIs List (by various additions – most recently 20 Dec. 2016)
 - singling out several specific VEB, VTB, Sberbank, Gazprombank and (most recently) Russian Agricultural Bank subs/affiliates – in Russia, Europe, and elsewhere
 - all of these were technically covered already under the 50%+ ownership rule – so now are named / singled out just for emphasis / clarity, to help stop circumvention, etc.
 - but also now any of these named subs would need official OFAC delisting if/when longer 50%+ owned by its "parent named SSI" (e.g., recent RDIF separation from VEB – but still on SSI List)
- the newest tightening (down to max. 14 days new debt) needs new implementing OFAC order

US Sectoral Sanctions – OFAC (*cont'd*)

Finance / Capital Markets (*cont'd*)

- new debt financing with maturity >60 days (*just revised down from >90 days* – again, once new OFAC rule issued) for these designated entities or their subs (50%-or-more owned), and transactions dealing in such debt (Directive 2)
 - *Gazpromneft* • *Novatek* • *Rosneft* • *Transneft*
 - here again, note the 30 July 2015, 20 Dec. 2016 and 20 June 2017 amended SSI Lists – singling out several specific Rosneft and Novatek upstream, downstream, finance and trading subs, and now Transneft subs – and the same two above-noted coverage caveats apply
- new debt financing, maturity >30 days, for Russian Technologies (Rostec) or its subs (50%-or-more owned), and transactions / dealing in such debt (Directive 3)
- See related OFAC FAQs (from May 2015)
 - FAQ 395 as amended, re permissible / prohibited US persons' activities with regard to L/Cs involving designated companies under Directives 1, 2 and 3
 - FAQ 419 as amended, re permissible / prohibited payment terms for US persons' sale of goods / provision of services to, and progress payments for long-term projects with, designated companies under Directives 1, 2 and 3
 - FAQ 371 re correspondent banking – OK only if the underlying transaction is (thus seems stricter than under EU rules – i.e., mere use of \$, without more, could violate)

US Sectoral Sanctions – OFAC (*cont'd*)

Energy

- Directive 4 prohibits (since Sept. 2014 – *and as just amended by the new Act*) without a license
 - the provision, export or re-export, directly or indirectly, of goods, services (except 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 Russia
 - involving any of these designated entities and or their subs (50%-or-more owned)
 - *Gazprom* • *Gazpromneft* • *Lukoil* • *Rosneft* • *Surgutneftegas*
 - *and the new Act expansion to cover such projects worldwide, where one of the five designated Russian companies has a ≥33% interest – and note also the clarified application only to “new” such projects*
 - and keep in mind the 30 July 2015 and 1 Sept. 2016 amended SSI List – singling out the same several Rosneft and Gazprom subs (and with same above-noted coverage caveats applying)
 - note also the 7 August 2015 BIS special designation of South Kirinsky field (only part of it is deep water) ... which might well be applied by OFAC too in practice
- Note OFAC (and BIS) FAQ clarification that “deepwater” = over 500 feet
- And OFAC (and BIS) FAQ clarification that “shale project” doesn’t include E&P *through* shale to locate or extract oil in reservoirs (*also, apparently, not all hard-to-extract = shale*)
- And OFAC clarifications re “Arctic offshore” (north of Arctic Circle) and re only production (vs. midstream / downstream) activities are covered

US Sectoral Sanctions – OFAC (*cont'd*)

Energy (*cont'd*)

- The further reference to “*in Russia or in other maritime area claimed by [Russia] and extending from its territory*” – likely means
 - any other offshore areas (inland / territorial seas, EEZ or Shelf) that aren’t Arctic
 - per a BIS FAQ answer, and analogous explanations under other-country sanctions rules (and consistent with EU Reg. clarifications)
 - and the Caspian Sea zone claimed by Russia (EU might not cover this?)
 - as well as the Black Sea shelf area extending from Crimea (despite non-recognition by US as being part of Russia)
- Note the FAQ 414 clarification that this sanction doesn’t apply if a project has potential to produce only gas
 - but *does* apply if potential for both
 - often not clear; factual / evidentiary showing may be key here
 - *and note that BIS (and likely OFAC too) considers condensate = oil* (this seemingly helps explain the 2015 special designation of South Kirinsky field)
- *Question* awaiting OFAC clarification: will Directive 4 now apply only to “new” projects in Russia too? And if so, conceivable retroactive effect of that change?

US Sectoral Sanctions – OFAC (*cont'd*)

Energy (*cont'd*)

- The Directive 4 export ban thus covers essentially
 - all US-origin goods, US-origin services, tech. assistance and technology in respect of such projects
 - to the five main listed companies and their subs (and now expressly including the added named Rosneft and Gazprom subs)
 - and also to/for use at the South Kirinsky field
 - *and note reports of the US government's recently expressed opposition to a Japanese consortium's proposed joint development with Rosneft of the similarly situated Central Tatarsky field – might conceivably lead to BIS designation of this field too*
- There have been some license applications / favorable actions under Directive 4 (but still a much stricter approach than in the EU to date)
- Note the “support services” compliance focus / risk

US Sectoral Sanctions – OFAC (*cont'd*)

General

- All four directives (re finance / capital markets, and energy) also expressly prohibit
 - any transaction that evades or avoids, has that purpose, or causes a violation of, or attempts to violate any of the directive prohibitions
 - any conspiracy formed to violate any of same
 - and again, note in this respect several 2015, 2016 and 2017 SSI List supplements – singling out, essentially just for anti-circumvention emphasis, several subs/affiliates of
 - Rosneft, Gazprom, Novatek and now Transneft (under Directives 2 and 4)
 - and VEB, VTB, Gazprombank and Russian Agricultural Bank (under Directive 1)
- And keep in mind now also section 228 of the new Act, which sets up a new secondary sanction rule against non-US persons that “materially violate, attempt or conspire to violate or cause a violation” of any Russian sanction, or facilitate significant transactions” for or on behalf of a person subject to a Russian sanction or family member (see slides 6-7)
- Possible penalties
 - Civil: up to circa \$284,000 (per recent inflation adjustment) per violation, or up to twice the value of the transaction that was the basis for the violation
 - Criminal: up to \$1 million per violation
 - And individuals could be imprisoned (for up to 20 years) for criminal violations

US Sectoral Sanctions – BIS

Export / Reexport Restrictions

- See below (slide 20) re the basic-limited August 2014 initial BIS Russia sanctions / license requirements – applying to *any* Russian end-users/uses
- Further, the same five OFAC-designated Russian energy companies (per Directive 4) have been on the BIS Entity List since Sept. 2014
 - *Gazprom* • *Gazpromneft* • *Lukoil* • *Rosneft* • *Surgutneftegas*
- Plus now 15 specifically named Rosneft subs since 2 Sept. 2015 and 51 named Gazprom subs since 7 Sept. 2016 (essentially the same as OFAC named)
- Also may (but doesn't automatically) apply to some owned or controlled subs – see BIS Entity List FAQs 20-22 (depends on nature of sub / its activities, control, and other factors)
- This specific Entity List designation imposes (re these companies, and at least several subs) – *see slide 20*
 - a new license requirement for export, re-export, or transfer of “*all items subject to the EAR*” (see slide 19)
 - when the exporter knows the items will be used directly or indirectly in exploration for or production of *oil or gas* in Russian deepwater, Arctic offshore, or shale formations
 - or is unable to determine whether the item will be used in such projects
 - and *presumption of denial* when for use in such projects “that have the potential to produce oil” (here again, grey area where could produce both gas and oil)
 - and importantly, as noted above, BIS considers that condensate = oil

US Sectoral Sanctions – BIS (*cont'd*)

Export / Reexport Restrictions (*cont'd*)

- Including, but not limited to
 - *drilling rigs*
 - *parts for horizontal drilling*
 - *drilling and completion equipment*
 - *subsea processing equipment*
 - *Arctic-capable marine equipment*
 - *wireline & down-hole equipment*
 - *drill pipe and casing*
 - *software for hydraulic fracturing*
 - *high pressure pumps*
 - *seismic acquisition equipment*
 - *remotely operated vehicles*
 - *compressors, expanders, valves, risers*
- And, per 7 August 2015 amendment, BIS added Gazprom's South Kirinsky field (Sea of Okhotsk, part of Sakhalin-3 areas project, off Sakhalin Island) to Entity List
 - regardless whether in deepwater portion or not (this field has both)
 - this special designation was likely based on some particular factors
 - more such fields might eventually be named too – *Rosneft's Central Tatarskiy?*
- Also further 2015, 2016 and 2017 amendments, adding many new Russian, Crimean, W. European and other OFAC-named SDN companies to the BIS Entity List
- *And more new BIS tightening and broadening updates are likely, per the new Act*

US Sectoral Sanctions – BIS (*cont'd*)

Export / Reexport Restrictions (*cont'd*)

- What is “*subject to the EAR*”?
 - all items in / moving in transit through the US
 - all US origin items, wherever located
 - and
 - *foreign-made goods that incorporate controlled US-origin goods*
 - *foreign-made software that is comingled with controlled US-origin software*
 - *foreign-made goods that are “bundled” with controlled US-origin software*
 - *foreign-made technology that is comingled with controlled US-origin technology*
 - ... in quantities exceeding the de minimus levels (25% for Russia, other than encryption technology) – *but special intricate rules re what items “count” here*
 - certain foreign-made direct products of US-origin technology or software
 - certain commodities, produced by any plant or major component thereof outside the US, that is direct product of US-origin technology or software
- *Note: includes even in-country transfers between entities (e.g., within Russia)*

US Sectoral Sanctions – BIS (*cont'd*)

Export / Reexport Restrictions (*cont'd*)

- The Commerce BIS August 2014 versus Sept. 2014 sanctions:
 - August – only specifically designated ECCN items and also several listed types of drill pipe, casings, wireline, downhole equipment (per Supp. No. 2 to § 746.5 of the EAR)
 - for *all* Russian entities
 - when used in Russian deepwater, Arctic offshore, or shale projects
 - September – plus *all* items subject to the EAR
 - for the 5 initially named energy sector companies (and likely most subs)
 - when used in Russian deepwater, Arctic offshore, or shale projects
 - and now also certainly for all the expressly named Rosneft and Gazprom subs
 - and for the South Kirinsky field too
 - *if... or if...* (the same oil/gas target projects litany applies here – and the rules of (i) denial presumption for oil projects, and (ii) condensate = oil, are applied in both contexts)
- But BIS also has discretion to apply these sanctions more broadly (i.e., without direct deepwater, Arctic offshore or shale link – if perceived unacceptable risk of diversion etc. (per 31 CFR 746.5(a)(2))

US Sectoral Sanctions – BIS (*cont'd*)

Export / Reexport Restrictions (*cont'd*)

- Note: BIS FAQ clarifications and license applications / actions (including re offshore drilling) – quite strict to date, like OFAC
- And see BIS 22 May 2015 Guidance on Due Diligence to Prevent Unauthorized Transshipment / Reexport of Controlled Items to Russia
 - expresses BIS concern “about efforts by front companies and other intermediaries who are not the true final end users...”
 - special focus on third-country freight forwarders and other dubious parties listed as an export item’s final destination
- Possible penalties
 - essentially same as for OFAC sanctions violations (see slide 16 above)
 - plus denial of US export privileges (including that no one can export US items to the penalized company)

US Crimea Sanctions

- Crimea-focused Executive Order (EO) 13685 of 19 Dec. 2014
 - bars all new direct or indirect US investments / transactions into Crimea – including for energy sector / offshore areas
 - and see the 29 Jan. 2015 BIS rules implementing the 19 Dec. 2014 EO
- And see 30 July 2015 OFAC Advisory Release re circumvention / evasion by omitting critical information in financial and trade transactions (further to the EO)
 - OFAC warns re
 - various patterns / practices in financial transactions which hinder correspondent banks' efforts to identify and interdict
 - note the substantial fines suffered in recent years by various European banks for similar-type violations of OFAC sanctions against countries other than Russia
 - similar practices in context of trade transactions – including in distributorship arrangements covering Russia
 - and advises various types of mitigation measures for these risks
- Note also these OFAC Crimea-related General License exceptions
 - No. 4 of 19 Dec. 2014 – permitting various food and agricultural products (including soft drinks, cigarettes, etc.) and medicines, medical supplies and devices
 - No. 9 of 22 May 2015 – permitting common internet-based communications (and see related OFAC FAQ 454)

US Direct Sanctions – SDNs

Specially Designated Nationals (SDN) List

- A few oil & gas industry executives have been on the OFAC's SDN list since 2014 (and expanded July and Dec. 2015, and Sept. and Dec. 2016, and June 2017) – most notably
 - Messrs. Sechin, Timchenko, and Rotenberg etc.
 - many other Russian / Crimean (and some European) business and political figures, and Russian gov't officials
- Such individual-person listing
 - bars US persons' dealings with them or their controlled companies, blocked assets etc.
 - generally measured by $\geq 50\%$ shareholding – *and including where two SDNs individuals collectively owning $\geq 50\%$ of a company*
 - but doesn't bar dealing with companies where they are just officers/directors, etc.
 - except has been interpreted to bar having an SDN-individual executive signing a contract on behalf of a non-SDN company (OFAC FAQs 398 and 400)
 - *see the July 2017 OFAC \$2 million penalty imposed on ExxonMobil for Mr. Sechin's signing Rosneft JV documents in 2014 – already being challenged by ExxonMobil in federal court*

US Direct Sanctions – SDNs (*cont'd*)

Specially Designated Nationals (SDN) List (*cont'd*)

- The further 2015, 2016 and 2017 SDN designations – persons, companies (including some Europeans and others – evidently controlled by and/or for assisting suspected evasion by some existing SDNs and some Russian state agencies and institutions (including Main Intelligence Dept., Federal Security Service, FAU Glavgosekspertiza)
- Several Crimean commercial port and transport companies (and some Russian ships that call in Crimea), banks and resort complexes are also named
- And in Sept. 2016 a number of companies involved in the Kerch Strait and other Russia/Crimea transport projects have been added
- And note Chernomorneftegaz (nationalized by Crimean gov't) is an SDN
- And a number of Russian defense industry companies (and some of their officers)
- *And note that in June 2017 Khudainatov's Independent Petroleum Co. ("NNK") was put on SDN List, for alleged oil dealings of an NNK Far Eastern subsidiary with North Korea*
- These are the US "direct" sanctions (as opposed to the SSI "sectoral" sanctions)
 - all US persons' dealings with – including payments to or receipt of goods/services from – SDNs and their subsidiaries are generally prohibited (and must block their assets)
 - but note: some detailed restrictions for US persons vis-à-vis SDNs seem to vary per specific provisions of each particular country sanctions regime
 - possible penalties – essentially same as above for other OFAC (and BIS) sanctions violations

US Direct Sanctions – SDNs (*cont'd*)

Specially Designated Nationals (SDN) List (*cont'd*)

- Two general licenses issued by OFAC to respond to / correct overbroad reach of the 1 Sept. 2016 and 29 Dec. 2016 designations of GGE and FSB as SDNs (connected to GGE's activities in Crimea and FSB alleged involvement in hacking / election-tampering):
 - OFAC General License No. 11 of 20 Dec. 2016 (entitled "Authorizing Certain Transactions with FAU Glavosekspertiza Rossii" - GGE)
 - gives blanket authorization for "all transactions and activities ... that are ordinarily incident and necessary to requesting, contracting for, paying for, receiving, or utilizing a project design review or permit from [GGE]'s office(s) in [Russia]" - except for carving out (i.e., still prohibiting) anything to do with GGE relating to Crimea
 - OFAC General License No. 1 of 2 Feb. 2017 (entitled "Authorizing Certain Transactions with the Federal Security Service" - FSB)
 - gives authorization for "all transactions and activities ... that are necessary and ordinarily incident to requesting, receiving, utilizing, paying for, or dealing in licenses, permits, certifications, or notifications issued or registered by [FSB] for the importation, distribution, or use of information technology products in Russia"
 - but "exportation, reexportation, or provision of any goods or technology subject the EAR (15 CFR Parts 730-774)" is subject to a BIS license, and fees payable to FSB shouldn't exceed \$5,000 annually
 - compliance with FSB law enforcement/administrative actions or investigations as well as regulations administered by FSB is authorized

US Direct Sanctions – SDNs (*cont'd*)

Specially Designated Nationals (SDN) List (*cont'd*)

- And note OFAC FAQs 501-504 of 8 Feb. 2017 repeating/clarifying certain points of General License No. 1
 - exportation of hardware and software directly to FSB or when FSB is an end-user is prohibited
 - no license is needed to travel to Russia / clear Russian border control which is under FSB jurisdiction
- *But now also the new Act, which stiffens restrictions on dealing with the FSB, and other Russian intelligence / defense-related entities, in various ways*
- And follow-up BIS Entity List revisions of:
 - 22 June 2017 – adding some newest OFAC Crimea-related SDN entities – thus essentially blocking exports/reexports to them having the requisite US content; and
 - 18 April 2017 – to jibe with OFAC General License No. 1 in relation to FSB
- An Oct. 2016 US federal court decision (in the Zarrab case) that may be seen/used to expand extraterritorial jurisdiction to enforce US sanctions vs. foreign companies
- OFAC “Guidance on the Provision of Certain Services...” of 12 Jan. 2017
 - provides some clarity as to what a US person (citizen or green card holder) legal counsel (in-house or outside) or compliance officer can/can’t do in advising a non-US company (employer, client) on the legality of proposed transactions under the US sanctions laws
 - essential point: can freely advise on whether complies/violates (and approve if complies) – but can’t otherwise “facilitate” by voting at Board level, signing the contract, etc.

US Ukraine Freedom Support Act

Overview

- The UFSA was signed into law by President Obama in Dec. 2014, after unanimous vote by both houses of Congress
- The commercial-sanctions parts (sections 4 and 5) lean toward some of the Iranian sanctions' reach) – i.e., primarily are
 - aimed at *foreign* companies / *foreign* financial institutions (*Russian ones too?*)
 - thus, they are so-called “secondary sanctions” (available for use to stop foreign companies' doing what US companies can't do)
 - discretionary (“may” rather than “shall”) for President to invoke or not – ... *but would tilt toward mandatory (upon certain findings) under the new Act*
 - waivable (and terminable) by the President upon certification ... *but this would become much more difficult under the new Act*
- Aimed at “significant investment” into a “special Russian crude oil project” (deepwater, Arctic offshore, shale – again, now would include South Kirinsky)
- And further possible special sanctions against Gazprom – for withholding gas supplies from Ukraine, Georgia, Moldova, or any NATO country

US Ukraine Freedom Support Act (*cont'd*)

Overview (*cont'd*)

- Also, possible sanctions against foreign finance institutions, for “significant transactions” involving an above “special Russian crude oil project” or Gazprom activities, or for facilitating financial transaction on behalf of an SDN)
- A menu of possible penalties is spelled out
- Also: mandatory sanctions to be imposed on Rosoboronexport (Russia’s giant arms exporter), and on other Russian entities that participate in arms sales / transfers into Ukraine and certain other countries
- In fact the UFSA-based commercial sanctions have not been invoked to date
 - but there has been some US gov’t saber-rattling re UFSA, with foreign companies / gov’ts
 - *and now, as of August 2017, the new Act will tighten the UFSA in various ways (e.g., as noted at slide 6 above)*
- The further political parts (authorization for military aid to Ukraine, support for democracy / civil society in Russia, etc.) – are a different matter ... (sections 6-11)
- The EU has not coordinated on UFSA-like measures to date (and seems unlikely to – all the more so with US adoption of the new Act)

EU Sectoral Sanctions

Overview

- The EU sanctions regime (most recently amended by Reg. No. 2015/1797 of 7 Oct. 2015) focuses on financial, energy, and dual-use / military sectors
 - was fairly well coordinated with the US regime ... but no longer, with the new US Act!
 - *e.g.*: no sanctions on anything re gas-focused projects (given Europe's dependence on Russian gas supplies) ... and maybe not interpreted to cover condensate (see slide 14)?
 - and no sanctions on any oil & gas projects with Russian participation outside Russia (or on Russian energy export pipelines)
 - and guidance notice exempting correspondent banking (payment / settlement services) from the loan/credit bans – thus may be seen as more lenient than analogous US rule / interpretation
- Much easier to grasp the basic EU rules than the US ones (and all the more so now, with the U.S. new Act!) – essentially all in one document's four corners
- *But the devil (?) is in the diversity:*
 - each member state competent authority interprets, authorizes (where called for) or denies, enforces, and sets / imposes its own penalties
 - unlike the US ... where this is all uniform, federal-level stuff
 - though some coordination / consistency is called for in the Reg.
 - and see EU Commission Notice of 16 Dec. 2014 (as amended 25 Sept. 2015) – FAQs

EU Sectoral Sanctions (*cont'd*)

Energy

- Per the initial 31 July 2014 energy-sector sanctions / authorization regime (article 3):
 - prior authorization is required for sale, supply, transfer or export, directly or indirectly, of the items *listed in Annex II*
 - to *any person or entity* in Russia or elsewhere
 - if for use in Russia (clarified to include its EEZ and continental shelf)
 - note that some of the Annex II item descriptions were refined / narrowed by Dec. 2014 amendment
 - authorization is to be considered / granted by competent authority “*of the member state where the exporter is established*”, per some general EU rules

EU Sectoral Sanctions (*cont'd*)

Energy (*cont'd*)

- but authorization shall not be granted for supply etc. of Annex II items
 - if reasonable grounds to determine that is for Russian oil (including condensate?) E&P projects:
 - ❖ in waters deeper than 150 meters (circa 492 feet)
 - ❖ in offshore areas north of the Arctic Circle
 - ❖ in shale formations by way of hydraulic fracturing (but not including E&P activities *through* shale formations to locate/extract oil from non-shale reservoirs)
 - ❖ *note:* not clear whether the US oil = condensate interpretation applies
 - except for
 - ❖ execution of obligation arising from contract concluded before 1 August 2014 – or, per Dec. 2014 liberalization, from “ancillary contracts necessary for the execution of such contracts”, or
 - ❖ items necessary in case of certain events threatening health, safety or environment

EU Sectoral Sanctions (*cont'd*)

Energy (*cont'd*)

Restricted activities include (per Reg. art. 3a, as amended Dec. 2014):

- Provision, directly or indirectly, of specified types of “associated services necessary for” deepwater, Arctic offshore, shale oil E&P projects (same litany-detail as art. 3 – see slide 30 above) in Russia including in its EEZ and shelf:
 - these specified types of services:
 - *drilling*
 - *completion services*
 - *well testing*
 - *supply of specialised floating vessels**
 - *logging*
- (* Note: 25 Sept. 2015 Guidance Notice FAQ 5 exempts “supply vessels such as platform supply vessels, anchor handling tug and supply vessels or emergency response vessels”)
- the same exceptions apply for
 - execution of an obligation arising from a prior (pre-12 Sept. 2014) contract / agreement or follow-on ancillary contracts, or
 - services necessary in case of certain events threatening health, safety or environment
 - again, apparently no scope for authorization here – rather, a pure prohibition for/to all (if neither of the above two carve-outs applies)

EU Sectoral Sanctions (*cont'd*)

Energy (*cont'd*)

- Also, provision of the following services related to any Annex II items needs authorization from national competent authority (per article 4.3 – existing since the initial July 2014 version of the Reg., and as refined by the Dec. 2014 amendment):
 - technical assistance (or brokering services) re Annex II items and re provision, manufacture, maintenance and use of those items directly or indirectly
 - to anyone in Russia (including its EEZ and Shelf)
 - or to anyone in any other country if concerns items for use in Russia (including EEZ / Shelf)
 - financing or financial assistance re Annex II items – including grants, loans and export credit insurance
 - for any sale, supply, transfer or export of those items
 - or for any provision of related technical assistance
 - also (as above for technical assistance) directly or indirectly to anyone in Russia (including its EEZ / Shelf) or to anyone in another country for use in Russia (including its EEZ / Shelf)
 - Per art. 4.4, authorizations may be granted on same basis as set out in art. 3 (and possible emergency services, with prompt post-reporting – per arts. 4.3 and 3.5)

EU Sectoral Sanctions (*cont'd*)

Finance – for Energy (and Military) Sector Companies

- Prohibits (per Reg. art. 5.2) purchase or sale of, provision of investment services for or assistance in issuance of, or other dealings with, certain debt or equity securities (and money-market instruments) issued after 12 Sept. 2014 by
 - *Rosneft, Transneft, Gazpromneft* (the three currently designated entities engaged in “sale or transportation of crude oil or petroleum products” – per Annex VI), their non-EU subs (>50% owned), or persons or entities acting at their behalf / direction
 - applies to debt securities with maturity >30 days
 - and note the relevant “transferable securities” definition – “... which are negotiable on the capital market” (some uncertainty re equity investment in LLC-type cos.)
 - and see 25 Sept. 2015 FAQ 30 allowing modifications to transferable securities depending on materiality – i.e., if would not “actually or potentially result in additional capital being made available”
- And same basic prohibition re 3 designated Russian entities connected with military-sector goods/services – including United Aircraft Corp. (per Annex V), with exception for space / nuclear sector entities (and a hydrazine exception)

EU Sectoral Sanctions (*cont'd*)

Finance – for Russian Banks

- Prohibits (per Reg. art. 5.1) purchase or sale of, provision of investment services for or assistance in the issuance of, or other dealings with, “*transferable securities*” or money-market instruments
 - issued by the 5 Russian banks designated in Annex III (Sberbank, VTB, Gazprombank, VEB, Rosselkhozbank – Russian Agricultural Bank)
 - or their non-EU subs (>50% owned)
 - so, essentially the same as in US OFAC sanctions
 - or persons or entities acting on their behalf or at their direction
- Applies to
 - debt securities issued (i) from 2 August to 12 Sept. 2014, with maturity >90 days; and (ii) after 12 Sept. 2014, with maturity ≥30 day
 - and to equity securities issued after 12 Sept. 2014
- See 25 Sept. 2015 FAQs 27-28 addressing what EU subs of targeted Russian bank entities can/can’t do (including warning re passing on funds = circumvention)

EU Sectoral Sanctions (*cont'd*)

Loans – for Energy (and Military) Sector Companies and Banks

- Prohibits (per Reg. art. 5.3) directly or indirectly making or being “part of any arrangement to make” new loans / credits with maturity >30 days after 12 Sept. 2014 to any entity covered under the previous two slides – namely
 - the three Russian energy-sector companies (per Annex VI)
 - the five Russian banks (per Annex III)
 - the three Russian military-sector companies (per Annex V)
 - or their non-EU subs, or persons acting on their behalf or at their direction
- And see 25 Sep. 2015 Guidance Notice, FAQ 25
 - rollover of an existing debt is allowed, subject to 30-day maturity restriction
 - but succession of rollovers each with maturity of ≤ 30 days may = circumvention

EU Sectoral Sanctions (*cont'd*)

Loans – for Energy (and Military) Sector Companies and Banks (*cont'd*)

- Certain carve-outs provided (per Reg. art. 5.3, amended as of Dec. 2014)
 - *trade finance exemption*: for “loans or credit having a specific / documented objective to provide financing for non-prohibited imports or exports of goods and non-financial services between the [EU] and any third State” (intended for use by targeted entity)
 - *but not* for purpose of *funding* any such entity (see art. 12)
 - practical approach to the interplay here: compliant vs. circumvention (see Reg. art. 12?)
 - and see 25 Sept. 2015 Guidance Notice FAQ 6: this exception “should be interpreted narrowly” (but also FAQs 6-16 clarifics.)
- And note further EU FAQ clarifics. (per Guidance Notice as amended 25/09/15)
 - post-Sept. 2014 cancellation of a pre-Sept. 2014 loan = prohibited new loan (FAQ 20)
 - a new term deposit at a targeted bank isn’t barred (but see FAQ 21 re circumvention)
 - correspondent banking (or other payment / settlement services) is not in itself = making or being part of arrangement to make new loan or credit (FAQ 22, and FAQ 2)
 - payment terms / delayed payment for goods/services ≠ prohibited loan/credit (but warning re “not in line with normal business practice” / circumvention – FAQ 24)

EU Sectoral Sanctions (*cont'd*)

Loans – for Energy (and Military) Sector Companies and Banks (*cont'd*)

- And note article 5.4 (introduced by Dec. 2014 clarification) – carving out from the general prohibition *new drawdowns / disbursements under pre-12 Sept. loan/credit contracts*
 - if
 - “all the terms and conditions” of such were agreed pre-12 Sept. 2014 and haven’t been modified since then; and
 - before 12 Sept. 2014 “a contractual maturity date has been fixed for the repayment in full of all funds made available ...”
 - possible issues re
 - whether “all” terms and conditions really mean *all* (ref. FAQ 30 by analogy?)
 - treatment of typical carry-type loans – re the “repayment in full” aspect
- Again, see the various 25 Sept. 2015 Guidance Notice FAQ clarifics.
- Note – many license applications / approvals to date (experience varying by member state)
- And note a new UK law granting power to impose fine of £1 million or 50% of transaction value for EU financial sanctions breaches as of 1 April 2017

EU Sectoral Sanctions (*cont'd*)

Important Overarching Provisions

- The Reg. also bans knowing and intentional participation in activities having object or effect of circumventing the above prohibitions (Reg. art. 12)
- But, per art. 10, no liability without knowledge or reasonable cause to suspect that actions would violate
- Jurisdictional reach – the Reg. applies (art. 13 – and see 25 Sept. 2015 FAQ 3):
 - within EU territory (or on board aircraft / vessels under member state jurisdiction)
 - to any person, wherever located, who is an EU member state national
 - to any entity, wherever acting, that is incorporated in an EU member state
 - to any entity “in respect of any business done in whole or in part within the Union”
- *Note the distinctions between US / EU regs. reach – especially with the new Act!*
- The “no claims ... shall be satisfied” provision (Reg. article 11)
 - but without prejudice to “judicial review of the legality of the non-performance of contractual obligations in accordance with this Regulation”
 - interesting for lawyers

EU Sectoral Sanctions (*cont'd*)

Separate Crimea Sanctions

- Reg. No. 692/2014 as amended
 - bars sale, supply, transfer, export of goods and technology (per an Annex II) to any Crimean company or for use there
 - covers oil & gas / other mineral resources and E&P, transport, telecoms, power sectors
 - and further general ban on financing, corporate acquisitions, JVs, investment in real estate, construction / engineering services, investment services, tourism services
- And see EU Information Note to EU Business Operating and/or Investing in Crimea/Sevastopol (Joint Working Doc. SWD/2014) of 17 July 2014
 - as amended 11 August 2014 and most recently 10 June 2015
 - gives updated summary of restrictions now in effect for EU-connected commercial activity there (though no real interpretive guidance)
- Note the still-reverberating July 2017 scandal re Siemens gas turbines that found their way to Crimea (evidently without the company's knowledge and despite its strict compliance efforts)
- And EU's new Sept. 2017 "blacklist" Reg. amendment to allow member state authorities to permit certain types of payments to Crimean Sea Ports

EU Direct Sanctions (SDN-like)

- The EU's SDN-like "blacklist" Reg. No. 269/2014 of 17 March 2014
- And more names have been added in a few update regs. since then (in 2014, 2015, 2016 and 2017)
- Individuals and entities (incl. a few just added per the Siemens turbines affair)
- All dealings with the blocked assets of listed persons (or their subs or certain other affiliates) etc. is generally prohibited
- Currently in effect to 15 March 2018 (extended as of 14 Sept. 2017)
- Note a published joint article of 17 June 2015 by ICC, LCIA and SCC on "The potential impact of the EU sanctions against Russian on international arbitration administered by EU-based institutions"
 - seeks to reassure Russian parties
 - notes availability of exemption for payment of legal fees and related expenses

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Almaty	Dallas	London	Paris	Silicon Valley
Astana	Dubai	Los Angeles	Philadelphia	Singapore
Beijing*	Frankfurt	Miami	Pittsburgh	Tokyo
Boston	Hartford	Moscow	Princeton	Washington, DC
Brussels	Hong Kong*	New York	San Francisco	Wilmington
Chicago	Houston	Orange County	Shanghai*	



Morgan Lewis

*Our Beijing office operates as a representative office of Morgan, Lewis & Bockius LLP. In Shanghai, we operate as a branch of Morgan Lewis Consulting (Beijing) Company Limited, and an application to establish a representative office of the firm is pending before the Ministry of Justice. In Hong Kong, Morgan Lewis has filed an application to become a registered foreign law firm and is seeking approval with The Law Society of Hong Kong to associate with Luk & Partners.

QUESTIONS?

© 2017 Morgan, Lewis & Bockius LLP
© 2017 Morgan Lewis Stamford LLC
© 2017 Morgan, Lewis & Bockius UK LLP

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners.

This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship. Prior results do not guarantee similar outcomes. Attorney Advertising.

Morgan Lewis