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informed



Ukraine and Russia: Report on Sanctions and Related Concerns

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Outline of U.S. Sanctions

- Executive Orders (EOs) impose sanctions against 31 individuals in Russia and Ukraine and one Russian bank
- Trade and investment with Russia are not restricted, except with the persons subject to sanctions and entities in which such persons have > 50% direct or indirect ownership interest
- Like EU, no country-based sanctions
- However, EOs set the stage for future sanctions to be adopted, if determined by U.S. authorities

Outline of U.S. Sanctions

- Persons on the U.S. sanctions lists are designated as Specially Designated Nationals (SDNs)
- Assets of SDNs are “blocked” and subject to special procedures if in the U.S. or in the possession of U.S. Persons
- U.S. persons may not have any dealings with SDNs or with entities owned 50% or more by an SDN (direct or indirect)
- U.S. guidance also advises caution in dealing with entities under “control” of SDNs via means other than 50% or more ownership
- Strict rules against assisting circumvention

Who Is Subject to Sanctions: “50% Rule”

- If an SDN/blocked party owns **50% or more** of another entity (Company A), that entity and all of its assets are blocked as well, *even if Company A is not on the SDN list*
 - Direct and indirect ownership included
 - U.S. persons required to block Company A’s assets and to refrain from engaging in transactions with Company A
 - Necessary to trace ownership structure up the ladder to ensure that SDN does not have indirect ownership interest

Who Is Subject to Sanctions: “50% Rule”

- Concept of “deemed SDN” or “shadow”
 - **Example 1:** a direct subsidiary of a listed Russian bank is treated as an SDN
 - **Example 2:** if two listed persons collectively own 76% of a listed Russian bank
- Due diligence requirements apply to direct and indirect ownership interests
- Unlike EU sanctions (discussed below), U.S. sanctions applicability revolves around ownership, not control; these are two separate concepts

Further Comments on Ownership and Control

Ownership = Automatic, Immediate Blocking & Prohibition

- SDN owns, directly or indirectly, 50% or greater interest in subject entity = entity is blocked regardless of whether specifically listed
- All transactions with SDN (direct as well as through a “third party intermediary”) are banned

Control = Possible Future Blocking & Prohibition

- Act with caution when considering transaction with entity in which SDN has significant ownership interest (<50%) or which SDN “controls” through other means
- Transactions with SDN through a “third party intermediary” are also banned
- Risk of future designation or enforcement, but not yet blocked

Who Must Comply with Sanctions: U.S. Persons

- U.S. sanctions are mandatory for “U.S. persons,” including:
 - U.S. citizens (wherever located) and permanent residents
 - U.S. legal entities
 - Foreign branches of U.S. entities
 - Any persons or entities located in the United States
- Currently foreign subsidiaries of U.S. companies are not included in EO’s definition of U.S. person, but caution is still advisable

Relationship of Sanctions to Non-U.S. Persons

- Risk of liability for assisting in circumvention of sanctions
 - **Example 1:** a Russian bank makes a ruble transfer to a Russian client in Russia. U.S. sanctions do not apply.
 - **Example 2:** a Russian bank seeks to process a U.S. dollar transfer to a sanctioned person in Russia. If the transfer is cleared through a U.S. bank or intermediary, it will be blocked.
 - **Example 3:** same as Example 2, except that the details of the payee are “masked” to avoid blocking. The U.S. authorities would consider this a breach.
 - **Example 4:** A U.S. person directs a prohibited transaction to its foreign subsidiary (“facilitation”)

Relationship of Sanctions to Non-U.S. Persons: Penalties

- Harsh civil and criminal penalties
- February 2014: U.S. announced penalties for circumvention of Iran sanctions
 - 18 businesses and 14 individuals identified
 - From Turkey, Spain, Germany, Georgia, Afghanistan, the United Arab Emirates, Liechtenstein, and Iran
 - Violators face restrictions on doing business in the United States and seizure of any property in the United States, among other penalties
- Large fines imposed on international banks and U.S. Persons for Iran-and Cuba-related violations

Other Related U.S. Actions

- FinCEN Advisory FIN-2014-A002 (March 6, 2014):
 - The Advisory cautions U.S. financial institutions to apply “enhanced scrutiny” to private banking accounts of 18 former Ukraine officials and associates, and to monitor transactions that might represent misappropriated or diverted state assets, or proceeds of corruption.
 - Current U.S. law effectively would require U.S. financial institutions to report transactions involving these persons to U.S. governmental authorities.

Other Risks; Possible Future Sanctions

- U.S. Department of Commerce Bureau of Industry & Security (BIS) has stopped approving licenses for exports to Russia
- Executive Orders allow future sanctions against:
 - Officials of Government of Russian Federation (potentially including officials of state-owned companies)
 - Persons operating in designated sectors of the Russian economy
 - Persons who materially assist, sponsor, or provide financial, material, or other support to sanctioned persons
- Depends on political and geopolitical events in future
- If future sanctions are adopted, this may affect current contracts and business dealings

Outline of EU Sanctions

- Sanctions against 51 Ukrainians and Russians (and affiliates) in:
 - EU
 - BVI, Cayman Islands, and other UK dependencies
- Like the United States, no country-based sanctions
- Threat of more individual-based sanctions
- Economic links between EU and Russia
- Business as usual?

EU Sanctions

- EU Regulations 208/2014, 269/2014, and 284/2014
- List 51 individuals – politicians and their relatives, plus one businessman (Serhiy Kurchenko). No other Russian or Ukraine “oligarchs”
- Article 2(1): “All funds and economic resources belonging to, owned, held or *controlled* by [a person listed in Annex 1] shall be frozen”
- Article 2(2): “No funds or economic resources shall be made available, directly or *indirectly*, to or for the benefit [a person listed in Annex 1]”

Circumvention

- Article 9: “It shall be prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent the measures referred to in Article 2”
- Catches service providers, employees, banks, clearing systems, etc.
- Obligations to inform governments about funds and economic resources

Territorial Limits

- EU Regulations apply:
 - within the EU
 - to EU nationals
 - to entities incorporated in the EU
 - to persons and entities in respect of business in the EU
- UK statutory instruments

Derogations/Exemptions

- “Competent authority” may approve payments by sanctioned persons under existing contracts
- Coordination by EU Sanctions Unit in Brussels
- Banks can get English court judgments, but not enforced without derogation

BVI/Cayman

- UK statutory instrument
- Similar to EU Regulation (although BVI, Cayman, etc. are not part of the UK or EU)

Effect of Sanctions

- Freeze funds and economic resources of sanctioned persons (and affiliates)
- No payments (without a derogation/license)
- No enforcement of security (without a derogation/license)
- Avoidance tactics tend not to work and may increase liability of persons employing such tactics
- Acceleration of loans (if an event of default occurs)
- Court judgment in England – *DVB Bank v. Shere Shipping Company* [2013] EWHC 2321

Case Studies on How Sanctions May Apply

- Letter of credit to Russian seller of goods to Cypriot affiliate of sanctioned person
- Sanctioned person owning a bond
- Ruble bank account of a sanctioned person
- Enforcement of security over Ukraine assets of BVI affiliate of sanctioned person
- Asset manager holding debt or equity securities of a company controlled by a sanctioned person
- Sanctioned person owns 33% of a company with the right to elect majority of company's directors

Response Strategies – Relationships with Russian or Ukraine Companies

- Sanction-related clauses in agreements – not much practical use but still necessary
- Due diligence on links to sanctioned persons – standard AML checks
- Business or property in Crimea
- Reputational risks in (1) United States/EU and (2) Russia
- Confusion between individual sanctions and country sanctions
- Close monitoring is essential – situation is extremely fluid

Future Sanctions?

- Chelsea Football Club
- Brooklyn Nets
- MasterCard
- London Stock Exchange

View from Moscow: Business Climate

- Business in Russia continues as usual for now
- Existing sanctions are perceived as limited; the market is adjusting
- A brief suspension of Visa/MasterCard operations this weekend caused a stir, but service has been restored
- However, deep concern about further sanctions among Russian companies and banks
- Discussion of potential damaging effects of broader sanctions for Russia, the EU, and other countries

View from Moscow: Russian Response to Western Sanctions

- Russian authorities responded with defiant statements
- Russia imposed visa bans on nine U.S. political leaders, including Senator John McCain and House Speaker John Boehner
- The Duma has reportedly discussed a draft bill to impose sanctions against EU and U.S. companies, but no details have been released
- To date, no other action from the Russian side
- Recent statements indicate that future Russian sanctions are likely to be “symmetrical”

Questions



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