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## Sanctions and Trade Update: Russia and Ukraine

TUESDAY, APRIL 01, 2014

In response to recent events in Ukraine, the United States, the European Union, Canada, Switzerland, and other nations have adopted a series of targeted asset freezes and travel bans, which vary in scope, as well as broader trade restrictions against Russia. The sanctions have targeted several dozen former Ukrainian officials, officials in the Ukrainian region of Crimea, senior Russian officials, members of the Russian Government's inner circle, and a Russian state-owned bank, Bank Rossiya. These measures create a variety of new compliance challenges for US and foreign firms and are likely to be followed by additional sanctions, unless there is a de-escalation of political tensions in the region.

The US and EU have also imposed a series of broader trade restrictions on Russia, including a freeze of EU-Russia trade talks and a suspension of US licensing for exports and re-exports of defense items and dual-use equipment by the US Departments of State and Commerce, respectively. Negotiations on Russia's accession to the Organization for Economic Cooperation and Development (OECD) and the International Energy Agency (IEA) have also been suspended. At the same time, Russia has retaliated with similar targeted sanctions against a variety of US and other officials, and a series of tit-for-tat measures could continue.

### **Compliance Challenges**

The recently imposed sanctions represent the most severe sanctions imposed against Russia since the dissolution of the Soviet Union. Nonetheless, most transactions with Russian or Ukrainian entities are unlikely to be affected. The measures do not generally block trade with or investment in Russia, and most Russian business enterprises will only be affected to the extent that they are owned or controlled by sanctioned individuals.<sup>1</sup>

These sanctions regulations create a variety of new compliance challenges. Generally, the sanctions impose obligations on all nationals, wherever located, of the respective sanctions-issuing jurisdiction, as well as to all individuals and entities operating or registered in that jurisdiction. The sanctions also prohibit a wide range of transactions with the targeted persons and entities, including, in certain situations, transactions involving intangible assets (such as contracts) that can be used to obtain funds, goods or services.

Firms operating in Russia, Ukraine, and the region more generally, as well as those with significant client bases from the affected countries, should review their records to determine whether they have engaged in past dealings with sanctions targets, either directly or through entities beneficially owned by them. This should include firms that act as intermediaries for certain transactions, including clearing banks. The regulations also generally prohibit the facilitation of activities to evade sanctions, which may include attempts to move or disguise assets or develop legal arrangements, such as shell companies, to shield assets from sanctions. Firms affected by the sanctions—including those who may need time to wind down activities with a sanctioned person—may in certain cases apply for specific licenses with the appropriate regulatory authorities.

With the US Congress prepared to finalize new Russia sanctions legislation this week, further sanctions against Russia appear likely. Further sanctions could include broader export restrictions, the listing of more Russian state-owned enterprises and oligarchs, a formal US and EU arms embargo, and potential action against Russia at the World Trade Organization (WTO). The EU has also reportedly drafted a list of 120 to 130 Russian individuals who could be further designated in the future. In short, the recent sanctions create a variety of new compliance obligations for US and foreign firms operating in Russia and throughout the region, and warrant close monitoring.

## **US Sanctions Action**

### *Executive Orders and OFAC Designations*

US President Barack Obama has issued three Executive Orders (EOs) authorizing sanctions against certain Ukrainian and Russian officials, and the US Department of the Treasury's Office of Foreign Assets Control (OFAC) has imposed sanctions on several dozen Ukrainian and Russian persons pursuant to these orders.

On March 6, 2014, the President signed Executive Order 13660 authorizing sanctions against any persons responsible for actions that undermine democratic processes or institutions in Ukraine or that threaten the peace and security of Ukraine.<sup>2</sup> It further authorizes sanctions against individuals who are involved in the misappropriation of Ukrainian state assets or have asserted governmental authority over any part or region of Ukraine without the authorization of the Government of Ukraine, as well as entities "owned or controlled" by such persons.

On March 17, 2014, the President signed Executive Order 13661, which expands the types of persons that could be sanctioned, focusing on Russia's invasion and annexation of Crimea.<sup>3</sup> The expanded EO targets Russian officials responsible for the invasion of Crimea, any individuals or entities that operate in the arms or related sectors in Russia, and any individual or entity that is "owned or controlled" by or supports any such Russian official.

On March 20, 2014, the President signed Executive Order 13662, which significantly expands the types of persons who may be sanctioned, including oligarchs in various private industries and other

persons who materially support senior Russian officials.<sup>4</sup>

In two sets of designations, OFAC has blocked the assets of several dozen Ukrainian and Russian individuals and entities, including Bank Rossiya, the seventeenth-largest bank in Russia.<sup>5</sup> Any assets of these persons in the United States must be frozen, and no transaction with these persons may involve a US person or occur within the United States.<sup>6</sup>

#### *US Financial Crimes Enforcement Network*

On March 6, 2014, the US Financial Crimes Enforcement Network (FinCEN), a bureau of the US Department of the Treasury that administers and enforces the anti-money laundering regulations applicable to financial institutions, took the rare step of issuing an advisory relating to asset freezes imposed by Canada and the EU against 18 Ukrainian officials (described further below), even though the US had not yet imposed similar sanctions. The FinCEN advisory alerted US financial institutions to the risk that these officials could seek to move their assets in a “deceptive fashion,” and reminded the financial sector of its obligation to identify and report suspicious activity. By setting forth the names and identifiers contained in the Canadian and EU designations, FinCEN provided specific information to US financial institutions to become part of their monitoring programs, although of course no asset freeze was required until OFAC took action.

#### *Suspension of ITAR and EAR Licensing*

The US Departments of Commerce and State have also announced a suspension of licensing for exports and re-exports to Russia of defense and dual-use items subject to the International Trafficking in Arms Regulations (ITAR) and Export Administration Regulations (EAR). Although these restrictions are “soft” sanctions, they can often have more wide-ranging impact in that they are country-wide (e.g., irrespective of transaction parties), whereas OFAC sanctions are limited to specifically designated persons. Certain EU Member States have imposed similar restrictions.<sup>7</sup>

#### *US Legislation*

Meanwhile, the US Congress is prepared to finalize new legislation this week that would formalize many of the sanctions measures issued by Executive Order and also expand the scope by including broader authorization for anti-corruption sanctions against Russian officials.<sup>8</sup> This legislation is likely to lead to further OFAC designations of Russian persons in the near future.

### **EU Sanctions Action**

The EU has imposed a variety of economic and political sanctions against the Russian Federation, including cancellation of the next EU-Russia Summit.

#### *EU Council Regulations*

On March 6, 2014, the EU Council passed Regulation No. 208/2014, which imposed a travel ban and asset freeze on 18 former Ukrainian officials responsible for the misappropriation of Ukrainian state funds and persons responsible for human rights violations in Ukraine.<sup>9</sup> Specifically, the Regulation provides that “[n]o funds or economic resources shall be made available, directly or indirectly, to or for the benefit” of the sanctioned individuals.<sup>10</sup> “Economic resources” is broadly defined to include “assets of every kind, whether tangible or intangible, movable or immovable, which are not funds, but may be used to obtain funds, goods or services.”<sup>11</sup> Under a broad interpretation, these sanctions could prohibit the implementation of various types of contracts with sanctioned persons. The Regulation also prohibits activities meant to circumvent the sanctions.<sup>12</sup> The Regulation creates compliance obligations for all activities within EU territory; nationals of all EU Member States, wherever located; and to entities registered or incorporated within any EU Member State.

On March 17, 2014, the EU approved a second Regulation No. 269/2014 imposing sanctions against 21 Russian and Ukrainian persons responsible for actions which undermine or threaten the territorial integrity, sovereignty and independence of Ukraine.<sup>13</sup> The list was not identical to the US lists and did not directly target any private individuals or state-owned enterprises, except to the extent that such enterprises may be owned or controlled by sanctioned persons. The scope of application was substantially similar to Council Regulation No. 208/2014.

On March 21, 2014, the EU approved a third regulation sanctioning 12 additional Russian and Ukrainian officials.<sup>14</sup>

### *EU Trade Actions*

The EU and Ukraine will sign the political provisions of an Association Agreement. The European Council has also affirmed that the EU and its Member States are committed to signing the remainder of the Association Agreement, which includes establishing a “Deep and Comprehensive Free Trade Area” between the EU and Ukraine. In addition, the EU will temporarily remove customs duties on Ukrainian exports to the EU. Finally, the European Council has requested the European Commission to examine Russian actions in Crimea and propose new economic and trade restrictions.

### *Future Sanctions*

EU leaders have indicated that future sanctions measures in this area are likely. Some reports indicate that a wide-ranging list of 120 to 130 Russian persons to be sanctioned has been prepared, including the heads of Russian state enterprises. EU officials have suggested that an arms embargo and more onerous trade-related restrictions are also being considered.

### **Sanctions Designations in Other Jurisdictions**

Other key jurisdictions, including Canada and Switzerland, have issued similar, although not identical, travel bans and asset freezes. In two recent orders issued on February 26, 2014 and March 7, 2014, Switzerland blocked the assets and economic resources (including “contract fulfillment guarantees or other financial commitments”) of numerous Ukrainian individuals, requiring all institutions holding or knowing of such persons’ assets to report them to Swiss authorities.<sup>15</sup> Furthermore, on March 5, 2014, Canada imposed asset freezes on the same 18 individuals against whom the EU initially imposed sanctions,<sup>16</sup> followed by a variety of additional asset freezes against Ukrainian and Russian persons.<sup>17</sup>

## Conclusion

Compared to other US and EU sanctions regimes, recent sanctions imposed against Ukrainian and Russian individuals and entities remain relatively limited, and most transactions are unlikely to be affected. However, both the targeted nature of the sanctions and the relatively complex business relationships among North American, European and Russian firms create unique compliance challenges. It is likely that the US and EU will continue to designate additional Russian entities, including state-owned Russian enterprises and oligarchs, in the weeks ahead. Accordingly, we recommend that US and foreign firms take appropriate steps to ensure compliance with these new sanctions measures and closely monitor developments over the coming weeks and months.

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<sup>1</sup> The United States will continue to consider entities “owned” by sanctioned individuals (e.g., if a sanctioned individual or combination of individuals owns 50% or more of the entity) to be automatically blocked, but determining “control” for compliance purposes may be more challenging. US officials have indicated that they may begin to specifically designate entities they determine to be “controlled” by the individuals sanctioned thus far to assist with compliance.

<sup>2</sup> Executive Order 13660, *Blocking Property of Certain Persons Contributing to the Situation in Ukraine*, Mar. 6, 2014, accessed at [http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine\\_eo.pdf](http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo.pdf).

<sup>3</sup> Executive Order 13661, *Blocking Property of Additional Persons Contributing to the Situation in Ukraine*, Mar. 17, 2014, accessed at [http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine\\_eo2.pdf](http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo2.pdf).

<sup>4</sup> Executive Order 13662, *Blocking Property of Additional Persons Contributing to the Situation in Ukraine*, Mar. 20, accessed at [http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine\\_eo3.pdf](http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo3.pdf).

<sup>5</sup> For a list of blocked persons, see US Department of the Treasury, Ukraine-related Designations, Mar. 17, 2014, <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/pages/20140317.aspx> and Mar. 20, 2014, [http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20140320\\_33.aspx](http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20140320_33.aspx).

<sup>6</sup> The asset freezes apply to “[a]ll property and interests in property that are in the United States, that hereafter come within the United States, or that are or hereafter come within the possession or control of any United States person (including any foreign branch)” of the sanctioned persons, and

those assets “may not be transferred, paid, exported, withdrawn, or otherwise dealt in.” See Executive Order 13660, Section 1(a). The sanctions also create compliance obligations for any U.S. citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States. *Id.* at Section 6(c).

<sup>7</sup>See, e.g., United Kingdom Export Control Organization, *Notice to Exporters 2014/06: UK suspends all licences and licence applications for export to Russian military that could be used against Ukraine*, Mar. 18, 2014.

<sup>8</sup>See H.R. 4152.

<sup>9</sup> The list can be found in the Annex of Council Regulation No. 208/2014, Mar. 5, 2014, *accessed at* <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:066:0001:0010:EN:PDF>.

<sup>10</sup>*Id.* at Article 2(2).

<sup>11</sup>*Id.* at Article 1(d).

<sup>12</sup>*Id.* at Article 9.

<sup>13</sup> The list can be found in the Annex of Council Regulation No. 269/2014, Mar. 17, 2014, *accessed at* <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:078:0006:0015:EN:PDF>.

<sup>14</sup> The list can be found in the Annex of Council Regulation No. 284/2014, Mar. 21, 2014, *accessed at* <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:086:0027:0029:EN:PDF>.

<sup>15</sup>See Swiss Financial market Supervisory Authority, Order of February 26, 2014 concerning Measures Against Certain Ukrainian Persons, Feb. 28, 2014, *accessed at* <http://www.admin.ch/bundesrecht/aop/00724/index.html?lang=de&download=NHZLpZeg7t,Inp6l0NTU042l2Z6ln1acy4Zn4Z2qZpnO2Yuq2Z6gpJCDeIN,gWym162epYbg2c> - (in German only); Order of March 7, 2014 concerning Measures Against Certain Ukrainian Persons, Mar. 10, 2014, *accessed at* [http://www.admin.ch/bundesrecht/aop/00724/index.html?lang=de&download=NHZLpZeg7t,Inp6l0NTU042l2Z6ln1acy4Zn4Z2qZpnO2Yuq2Z6gpJCDeIN\\_f2ym162epYbg2c](http://www.admin.ch/bundesrecht/aop/00724/index.html?lang=de&download=NHZLpZeg7t,Inp6l0NTU042l2Z6ln1acy4Zn4Z2qZpnO2Yuq2Z6gpJCDeIN_f2ym162epYbg2c) - (German only).

<sup>16</sup> SOR/2014-44, *Freezing Assets of Corrupt Foreign Officials (Ukraine) Regulations*, Mar. 5, 2014, *accessed at* [http://www.international.gc.ca/sanctions/ukraine\\_developments-developpements\\_ukraine.aspx?lang=eng](http://www.international.gc.ca/sanctions/ukraine_developments-developpements_ukraine.aspx?lang=eng).

<sup>17</sup> For an overview of these sanctions, see <http://www.international.gc.ca/sanctions/russia-russie.aspx?lang=eng> and <http://www.international.gc.ca/sanctions/ukraine.aspx?lang=eng>.

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