# EU and United States Further Broaden the Scope of Sanctions and Restrictive Measures Targeting Russia

EU and U.S. government officials recently imposed additional sanctions targeting Russia. Current sanctions do not prohibit all trade or other transactions with Russia, but rather comprise an increasingly broad and complex set of restrictions. In light of this complexity, companies will want to involve persons with appropriate expertise in any existing or potential business involving Russia to avoid costly mistakes under laws that impose criminal and civil penalties for violations.

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## EU Sanctions

On July 31, 2014, the EU implemented a program of sanctions and restrictive measures designed to target Russia and persons deemed responsible for actions which are considered to undermine or threaten the territorial integrity, sovereignty and independence of Ukraine.[1] Our previous client alert, dated August 2014, provides a summary of these sanctions and restrictive measures, which applied restrictions on: (i) access to the capital market for certain financial institutions; (ii) the sale, supply, transfer or export of certain technologies for the Russian energy industry; (iii) the export (and services related to the provision of) dual-use goods; and (iv) on services related to the supply of arms and military equipment.[2]

At the same time, the European Council called for preparatory work on proposals for significant further steps to be taken should the situation on the ground in eastern Ukraine further deteriorate. Over the past few months, the situation on the ground in eastern Ukraine has continued to deteriorate, and during the Special Meeting of the European Council on August 30, 2014, the European Council condemned the increased inflow of fighters and weapons from Russia into eastern Ukraine, and requested that significant further restrictive measures be taken.[3] As a result, on September 8, the EU issued Regulation 960/2014 (the "Regulation"), which significantly extends the existing restrictive measures. The EU also issued Regulation 961/2014, which added 24 new individuals (but no new entities) to the asset freeze list.[4]

*The EU Regulation*

The Regulation entered into force on September 12, 2014, and applies within the EU, on board any aircraft or vessel under the jurisdiction of a Member State, to any individual who is a national of a Member State wherever in the world they are located, to any entity which is incorporated in a Member State, and to any individual or entity in respect of business done in the EU. The Regulation:

1. significantly increases the restrictions on the access to the capital market for certain financial institutions and applies similar restrictions on certain military and energy companies;
2. applies restrictions on lending to certain financial institutions, military and energy companies;
3. increases the scope of the restrictions on the supply of certain technologies for the Russian energy industry;
4. increases the scope of the restrictions on the export of dual-use goods and technologies and on the provision of related services; and
5. increases the scope of the restrictions on the supply of certain services related to the supply of arms and military equipment.

**The regulation significantly increases the restrictions on the access to the capital market for certain financial institutions and applies similar restrictions on certain military and energy companies.**

We discuss these elements briefly below.

*Capital markets and lending restrictions*

Our alert of August 2014 set out the restrictions introduced under Regulation 831/2014 in relation to access to the capital market. That regulation prohibited (directly or indirectly) buying, selling, dealing or providing brokering or assistance in the issuance of *transferable securities* and *money-market instruments*[5] with a maturity exceeding 90 days issued after August 1, 2014, by five Russian financial institutions[6] (and certain associated entities).

The scope of this restriction has now been significantly increased to prohibit (directly or indirectly) buying, selling, dealing or providing *investment services*[7] or assistance in the issuance of transferable securities and money-market instruments with a maturity exceeding 30 days issued after September 12, 2014, by:

1. those five Russian financial institutions previously listed;
2. entities established in Russia predominantly engaged in the conception, production, sales or export of military equipment and services, as listed in Annex V of the Regulation;[8]
3. entities established in Russia that are publically controlled or with over 50% public ownership and with estimated total assets of over 1 trillion Russian Rubles and whose estimated revenues originate for at least 50% from the sale or transportation of crude oil or petroleum products, as listed in Annex VI of the Regulation;[9]
4. any entity established outside the EU that is more than 50% owned by one of the financial institutions, military firms or energy firms (described at 1 to 3 above); or

5. any entity acting on behalf or at the direction of any of those entities referred to at 1 to 4 above.

As with the earlier regulation, while the definition of investment services is wide (and includes portfolio management), it is limited to the specified transferable securities and money-market instruments in relation to those entities listed.

Separately, the Regulation also prohibits directly or indirectly making (or being part of an arrangement, such as a syndicate, to make) any new loans or credit with a maturity exceeding 30 days to any of those entities listed at 1 to 5 above (with certain limited exceptions).

*Energy industry technologies*

The earlier regulation imposed a requirement to seek authorization for the sale, supply, transfer or export of certain energy industry technologies, which were listed in that regulation. The purpose of this restriction was to prevent those technologies being used for deepwater oil exploration and production, Arctic oil exploration and production or shale oil projects in Russia. The Regulation expands this restriction to prohibit the provision of certain services for deep-water oil exploration and production, Arctic oil exploration and production or shale oil projects in Russia, regardless of whether those listed technologies are involved. The prohibited services are: (i) drilling; (ii) well testing; (iii) logging and completion services; and (iv) supplying specialized floating vessels.

**The earlier regulation imposed a requirement to seek authorization for the sale, supply, transfer or export of certain energy industry technologies, which were listed in that regulation.**

There are some limited exceptions to this prohibition, including that it will not apply where the obligation to provide the services arises under a contract concluded before September 12, 2014.

*Dual-use goods and arms and military equipment*

The earlier regulation imposed a prohibition on the sale, supply, transfer or export, either directly or indirectly, of dual-use goods and technology (whether or not that technology originates in the EU) to any individual or entity in Russia or for use in Russia, if those items are, or may be intended for, military use or for a military end user. The Regulation expands this restriction to specifically prohibit the sale, supply, transfer or export, either directly or indirectly, of dual-use goods and technology to certain listed Russian defense companies, whether or not they are specifically intended for military use.[10] The Regulation also restricts the provision of technical assistance, brokering services, financing or financial assistance related to the supply of dual-use goods and technology to those listed Russian companies.

There are some limited exceptions to this prohibition, including that it will not apply where the obligation to provide the services arises under a contract concluded before September 12, 2014.

The existing restrictions on the provision of (direct or indirect) technical assistance, financing or financial assistance related to arms and military equipment to any individual or entity in Russia or for use in Russia has been extended by the Regulation to also include a prohibition on the provision of insurance or reinsurance related to such equipment.

**The U.S. Department of the Treasury has targeted an additional sector of the Russian economy — the defense and related materiel sector.**

## U.S. Sanctions

On September 12, 2014, in coordination with EU authorities, the U.S. Department of the Treasury and U.S. Department of Commerce announced additional sanctions, citing Russia's continued "efforts to destabilize" eastern Ukraine. The U.S. Department of the Treasury has targeted an additional sector of the Russian economy — the defense and related materiel sector. The new sanctions also expand restrictions related to Russia's energy and financial sectors. The expansion of sanctions highlights the continued risks that exist for companies with business related to Russia, particularly under a March 2014 Presidential Executive Order, which authorizes the expansion of sanctions to additional strategic Russian sectors as deemed appropriate in response to the evolving military and political situation with Russia and eastern Ukraine.

*New Sectoral Sanctions*

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) issued two new Directives on September 12, 2014, related to OFAC's Sectoral Sanctions Identifications (SSI) List. As we reported in prior Client Alerts[11], the SSI List imposes restrictions on certain transactions by "U.S. persons," which include U.S. citizens located anywhere in the world, U.S. companies including their branch offices outside the United States, and any person while located in the United States. Prohibitions on U.S. persons in effect also restrict the use of U.S. dollars in transactions targeted under the sanctions.

Under OFAC's new Directive 3, U.S. persons are prohibited from engaging in transactions involving "new debt" with maturity terms of longer than 30 days related to any listed company operating in Russia's defense and related material sector companies.[12] The new sanctions also broadened existing sanctions that target listed Russian financial services sector entities (Directive 1). The prior sanctions prohibited "new debt" and "new equity" transactions with 90 days maturity with listed entities. As of September 12, 2014, the maturity period was reduced, so that "new debt" and "new equity" transactions that have 30 days maturity are covered. Russia's Sberbank, cited by U.S. authorities as Russia's largest bank, accounting for approximately one-quarter of Russian banking assets and one-third of its banking capital, also was added to these prohibitions. In a move to liberalize some of the Russia sanctions, on the other hand, OFAC issued general authorization for certain derivative products.[13]

Additionally, both OFAC (in new Directive 4) and the U.S. Department of Commerce issued sanctions that are similar to the EU sanctions, which in effect prohibit certain transactions involving U.S. persons as well as U.S.-origin goods and technology related to exploration or production for Russian deepwater, Arctic offshore, or shale projects that are related to the production or potential production of oil. These transactions are prohibited where they relate to listed entities, currently Gazprom, Gazprom Neft, Lukoil, Surgutneftegas, Rosneft and Transneft. Gazprom and Gazprom Neft also were added to the existing SSI List targeting Russia's energy sector (Directive 2), which prohibits U.S. person transactions involving "new debt" of greater than 90 days maturity.

*Addition of Entities to OFAC and Commerce Sanctions Lists*

OFAC also designated several Russian state-owned defense technology firms on its Specially Designated Nationals and Blocked Persons List (SDN List), so that U.S. persons generally are prohibited from any transactions, directly or indirectly, involving these entities and are required to "block" any of these entities' assets or property interest that come into their possession. The U.S. Department of Commerce added several Russian entities operating in the defense and energy sectors to its Entity List, so that licenses are required for exports or reexports of U.S. origin goods and technology to these entities.

## Sanctions Risk Mitigation

The EU has broadened the scope of its sanctions and restrictive measures against Russia, and companies doing business in the region should continue to carefully keep their operations under review to ensure they do not fall foul of the regime. This is particularly the case for businesses operating in the defense and energy industries, as well as those involved more generally in the provision of finance to Russian businesses. Certain EU leaders have suggested that if the current tentative cease-fire can be maintained, it is possible that the breadth of sanctions and restrictive measures will be narrowed, although it is equally possible that, should the situation (which remains volatile) deteriorate, they may be broadened at short notice.

U.S. sanctions do not prohibit all trade or other transactions by U.S. persons with Russia. However, the prohibitions continue to expand, and complying with the targeted sanctions is increasingly complicated. Companies doing business, directly or indirectly with Russia, or eastern Ukraine, should ensure heightened diligence is performed so that this business complies with the sanctions restrictions. Risk mitigation measures should include diligent and frequently updated screening of counterparties against the evolving U.S. sanctions lists, as well as export control statements and sanctions compliance requirements for third parties on sales and shipment documentation. Heightened background research also likely should be undertaken, to ensure that counterparties are not owned or controlled by sanctioned entities. Entities that are 50% or more owned by one or more sanctioned entities are considered to be sanctioned, and entities controlled by sanctioned parties are at significant risk of becoming sanctioned parties.

**Companies doing business, directly or indirectly with Russia, or eastern Ukraine, should ensure heightened diligence is performed so that this business complies with the sanctions restrictions.**

1 Council Regulation (EU) No 833/2014 of 31 July 2014, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:JOL_2014_229_R_0001

2 See Kirkland Alert "EU Broadens the Scope of Sanctions and Restrictive Measures Targeting Russia" dated August 2014, http://www.kirkland.com/siteFiles/Publications/Alert_08182014.pdf

3 Special Meeting of the European Council, 30 August 2014, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/144538.pdf

4 Council Implementing Regulation (EU) No 961/2014 of 8 September 2014, amending Council Regulation (EU) No 269/2014 of 17 March 2014, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.271.01.0008.01.ENG

5 "Transferable securities" and "money market instruments" are defined in our alert "EU Broadens the Scope of Sanctions and Restrictive Measures Targeting Russia" dated August 2014, http://www.kirkland.com/siteFiles/Publications/Alert_08182014.pdf

6 Sberbank, VTB Bank, Gazprombank, Vnescheconombank (VEB) and Rosselkhozbank.

7 "Investment services" is defined in the Regulation, and is identical to the definition of "brokering" in the earlier regulation, as: (i) reception and transmission of orders in relation to one or more financial instruments; (ii) execution of orders on behalf of clients; (iii) dealing on own account; (iv) portfolio management; (v) investment advice; (vi) underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; (vii) placing of financial instruments without a firm commitment basis; and (viii) any service in relation to the admission to trading on a regulated market or trading on a multilateral trading facility.

8 OPK Oboronprom, United Aircraft Corporation and Uralvagonzavod.

9 Rosneft, Transneft and Gazprom Neft.

10 JSC Sirius, OJSC Stankoinstrument, OAO JSC Chemcomposite; JSC Kalashnikov, JSC Tula Arms Plant, NPK Technologii Maschinostrojenija, OAO Wysokototschnye Kompleksi, OAO Almaz Antey, and OAO NPO Bazalt.

11 See Kirkland Alert "U.S. Sanctions Update: New Parties and Key Sectors Targeted in Russia, Further Increasing Risks for Global Companies" dated August 2014, http://www.kirkland.com/siteFiles/Publications/Alert_8142014.pdf, and Kirkland Alert "U.S. Sanctions Update: New Sanctions Program Creates Risks for Companies Doing Business with Russia or Ukraine" dated March 2014, http://www.kirkland.com/siteFiles/Publications/Alert_031914.pdf

12 Currently, Rostec is named on this list.

13 OFAC General License 1A, "Authorizing Certain Transactions Related to Derivatives Prohibited by Directives 1, 2, and 3 under Executive Order 13662" (Sept. 12, 2014).

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