



EU and US Sanctions

Summary of Norms and Application Guidelines for Russia

**AEB Legal Committee,
Supported by Baker&McKenzie – CIS, Limited
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EU Sanctions

INTRODUCTION (1)

- The EU traditionally adopts 'smart sanctions' policies instead of complete embargoes → targeted trade restrictions directed against specific persons, companies, entities, bodies, industry sectors and/or activities
- Sanctions are included in **decisions** and **regulations**:
 - **Decisions** are only binding on EU Member States → need to be implemented before becoming binding on companies and persons
 - **Regulations** are binding on companies and persons → no implementation required
 - Note: Often enter into force on day of publication

INTRODUCTION (2)

- More and more individuals are becoming subject to sanctions → not only nationals of 'usual suspect' countries like Iran, Syria and North Korea, but also from countries like Egypt, Tunisia, Belarus, etc., **and now – Russia and Ukraine**
- Sanctions are constantly kept under review → checks are performed on a regular basis: what is permitted today may become prohibited tomorrow and vice versa
- Sanctions imposed by other countries or organizations (U.S., Canada, Switzerland, the United Nations, etc.) are not always similar or in line with EU sanctions

SCOPE OF EU SANCTIONS

Principle

- Persons within the EU territory (including transit and airspace)
- Persons on board aircraft or vessels under EU Member State jurisdiction
- Persons with EU Member State nationality, regardless of location
- Any legal individual, entity or body incorporated or constituted under laws of EU Member States
- Any legal individual, entity or body in respect of any business done in EU

Example

- Korean national visiting a branch of a Korean entity in Belgium
- Australian national on board a Lufthansa airplane
- French national working for a Russian entity in Russia
- Dutch entity (including its non-EU branch offices, e.g. in Russia)
- Canadian entity enters into an arrangement with a UAE entity where the financing is dealt with by a UK entity

WHICH SANCTIONS ARE RELEVANT FOR AN EU ENTITY'S BUSINESS?

- I. Designated Person ('DP') Controls
- II. Anti-circumvention Clause
- III. Knowledge Defense

I.a. DESIGNATED PERSON CONTROLS – GENERAL (1)

- DPs can be individuals, legal entities or bodies, inside or outside of residence country
- Entities owned or controlled by those listed as DP = DPs
- Sanctions against DPs include:
 - Freezing of funds and economic resources belonging to, owned, held or controlled by DPs
 - Prohibiting the making funds or economic resources available, directly or indirectly, to or for the benefit of a DP

I.a. DESIGNATED PERSON CONTROLS – GENERAL (2)

- Funds: financial assets and benefits of every kind, including, but not limited to cash, bills of lading, credit, debit, cheques, guarantees, bond, dividends, etc.
- Economic resources: assets of every kind, whether tangible or intangible, movable or immovable, which are not funds but which may be used to obtain funds, goods or services
 - EU entity's products or services = economic resources

I.b. DESIGNATED PERSON CONTROLS – GUIDELINES (1)

- On 30 April 2013 the Council of the European Union published the [‘Guidelines on implementation and evaluation of restrictive measures \(sanctions\) in the framework of the EU Common Foreign and Security Policy’](#)
- Aim of guidelines is to reach a common understanding on the notion of ‘ownership and control’ by DPs and on the concept of ‘making indirectly available funds and economic resources to DPs’

I.b. DESIGNATED PERSON CONTROLS GUIDELINES (2): OWNERSHIP

- Criterion to be taken into account when assessing whether a legal person or entity is owned by another person or entity
- Possession of more than 50% of the proprietary rights of an entity or having majority interest in it
- If this criterion is satisfied: legal person or entity is owned by another person or entity
- However, the fulfilment of the criterion of ownership may be refuted on a case by case basis

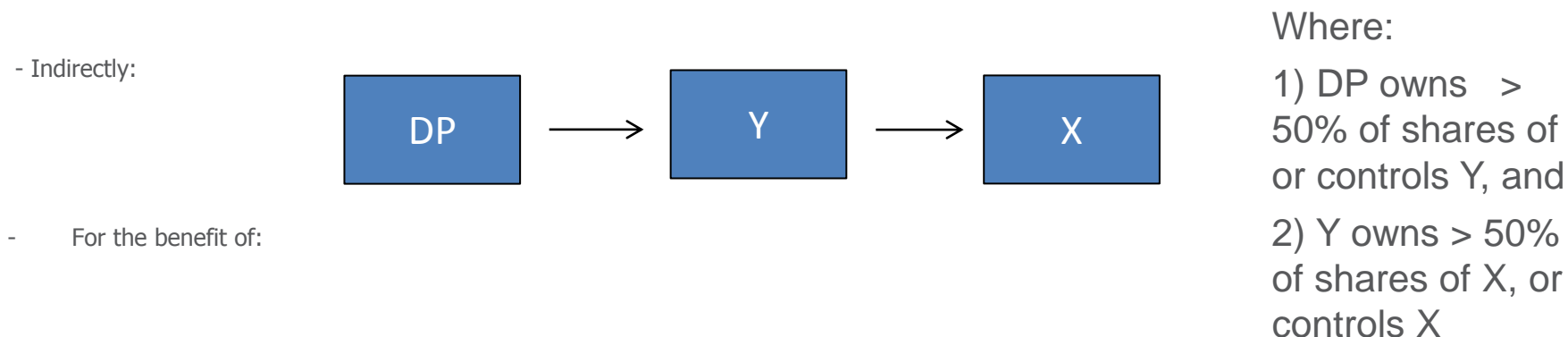
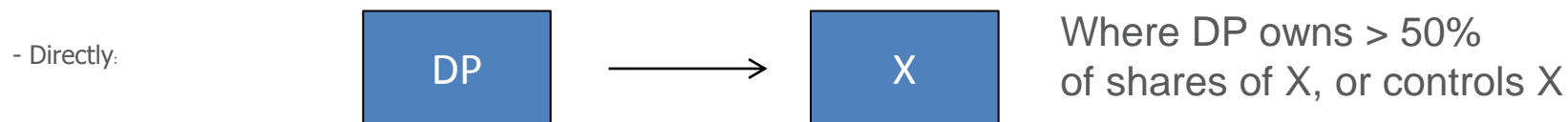
I.b. DESIGNATED PERSON CONTROLS GUIDELINES: CONTROL (3)



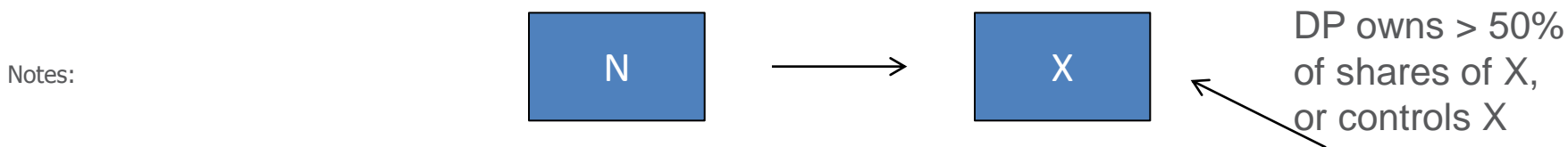
If any of the control criteria are satisfied: legal person or entity is controlled by another person or entity, unless the contrary can be established on a case by case basis. Control criteria include inter alia:

- Having the right or exercising the power to appoint or remove a majority of the members of the administrative, management or supervisory body of such legal person or entity
- Having the right to use all or part of the assets of a legal person or entity
- Managing the business of a legal person or entity on a unified basis, while publishing consolidated accounts
- Controlling alone, pursuant to an agreement with other shareholders in or members of a legal person or entity, a majority of shareholders' or members' voting rights in that legal person or entity
- Having appointed solely as a result of the exercise of one's voting rights a majority of the members of the administrative, management or supervisory bodies of a legal person or entity who have held office during the present and previous financial year
- Sharing jointly and severally the financial liabilities of a legal person or entity, or guaranteeing them
- Having the right to exercise a dominant influence over a legal person or entity, pursuant to an agreement entered into with that legal person or entity, or to a provision in its Memorandum or Articles of Association, where the law governing that legal person or entity permits its being subject to such agreement or provision
- Having the power to exercise the right to exercise a dominant influence referred to in the previous bullet point, without being the holder of that right (including, for example, by means of a front company)

I.c. DESIGNATED PERSON CONTROLS



- For the benefit of:



- "DP" – Designated Person under the EU sanctions
- "X" – legal entity or asset directly/indirectly subject to the EU sanctions
- "Y" – a third party legal entity directly subject to the EU sanctions
- "N" - a third party legal entity not subject to the EU sanctions



I.d. DESIGNATED PERSON CONTROLS: CONSIDERATION

- Factors to consider in assessing risk of 'indirect' and/or 'to the benefit of' dealings:
 - Shareholders (wholly owned/majority/minority)
 - Directors/Managers (control)
 - Nature of products/services (easily transferable)
- Screening
 - Of all parties involved (customer, agent, distributor, bank, freight forwarder, etc.)
 - At various stages in the transaction chain (customer registration, order intake, shipment, etc.)
 - Keep records of screening results and background checks

II. ANTI-CIRCUMVENTION CLAUSE

- The clause reads as follows:

It shall be prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent the measures in Article ...

- 'Restructuring' of certain activities in order to avoid EU sanctions jurisdiction is therefore prohibited

III. KNOWLEDGE DEFENSE

- The clause reads as follows:

The prohibitions set out in ... shall not give rise to liability of any kind on the part of the natural or legal persons or entities concerned, if they did not know, and had no reasonable cause to suspect, that their actions would infringe these prohibitions

- Requires due diligence checks to be conducted
- Doing nothing is insufficient basis for the knowledge defense

IV. SECTORAL SANCTIONS (1)

EU Regulation No. 833/2014 dated 31 July 2014 introduced sectoral sanctions with respect to the following Russian companies and industries (applicable to all EU persons):

- Ban on long-term borrowings, investment in debt instruments exceeding the term of 90 days and issued after 1 August 2014 for:
 - Sberbank
 - VTB Bank
 - Gazprombank
 - VEB
 - Rosselkhozbank
- Ban on certain transactions with dual-use and military items – risks for already concluded contracts
- Restriction on transactions and brokering services with certain specifically listed oil industry equipment and technologies (prior authorization required)

IV. SECTORAL SANCTIONS (2)

EU Regulation No. 825/2014 dated 30 July 2014 introduced a prohibition for all EU persons to do the following business activity in Crimea and Sevastopol:

- Provide financial loan or credit, or creation of JVs relating to the creation, acquisition or development of infrastructure in the areas of transport, telecommunications or energy
- Provide financial loan or credit, or creation of JVs relating to the creation, acquisition or development of infrastructure in the areas of exploitation of oil, gas or mineral resources
- Transfer, supply, sell, export directly or indirectly of specifically listed key equipment and technology related to transport, telecom, energy, exploitation of oil, gas and mineral reserves



Impact of U.S. Sanctions

I.a. U.S. SANCTIONS IMPACT ON NON-U.S. ENTITIES

- In what cases do the U.S. rules apply?
 - U.S. persons (also greencard holders)
 - Products of U.S. origin (also < 100% U.S. content)
 - USD transactions

- Be aware of indirect U.S. jurisdiction
 - Clauses in financing arrangements
 - U.S. investments

I.b. U.S. SANCTIONS FOR RUSSIA/UKRAINE

- Apply to “U.S. Persons”:
 - U.S. companies and their foreign branch offices
 - non-U.S. subsidiary **is not** a U.S. Person
 - U.S. citizens and permanent resident aliens (green card holders), wherever located
 - All persons/entities physically located in the U.S.
- Sanction individuals and entities listed by U.S. Treasury’s Office of Foreign Assets Control (OFAC) as Specially Designated Nationals (SDNs)
- SDN travel ban, asset freeze and prohibition of nearly all forms of U.S. Person involvement in transactions, be it direct or indirect
- **NOTE:** any restrictions on dealing with SDNs extend to entities in which a single SDN holds, directly or indirectly, a 50% or greater ownership interest
 - No “control” test !

II. PROHIBITED U.S. PERSON INVOLVEMENT (1)

- Also known as 'facilitation'
- Examples of U.S. Person involvement include:
 - Supply of product/services to third parties with knowledge or reason to know items are destined for a SDN
 - U.S. management approvals/directions for any dealings with SDN
 - Financing, bank guarantees, warranties
 - Referral of SDN orders to non-U.S. persons
 - Negotiation/review of commercial terms/contracts with SDN

II. PROHIBITED U.S. PERSON INVOLVEMENT (2)

- Certain forms of IT infrastructure support and IT access/services
- Other support (technical, legal, credit review, etc.)
- No facilitation: the non-U.S. subsidiary has to have:
 - The independent authority to enter into agreements
 - The independent ability to perform a transaction without U.S. Person involvement
 - **BUT:** provision of this authority and ability as a result of U.S. sanctions introduction, without objective business reason = **circumvention**

III. U.S. SECTORAL SANCTIONS

On 16 July 2014 US Office of Foreign Assets Control (OFAC) of U.S. Department of Treasury issued Executive Order 13662 Sectoral Sanctions Identifications List (the "List"). The list consists of 2 Directives (Directive 1 and Directive 2):

- Directive 1 (Financial Sector) prohibits U.S. persons transacting in, providing financing for, or otherwise dealing in new debt of longer than 90 days maturity or new equity for the listed persons, their property, or interests in property of:
 - Vnesheconombank (VEB) Gazprombank (as of July 16, 2014), and,
 - VTB, Bank of Moscow and Rosselkhozbank (as of July 29, 2014)
- Directive 2 (Energy Sector) relates to the Russian energy sector and applies also to Russian companies "Rosneft" OJSC and "Novatek" OJSC, establishing the same prohibitions as provided under Directive 1 except for dealing in new equity
- All other transactions with the persons subject to Directives 1 and 2 are allowed
- OFAC issued General License No. 1 to authorize US-Person dealings in derivate products linked to underlying assets that constitute new debt described above
- The sectoral sanctions should be observed by any "U.S. Person"

Compliance Tips

COMPLIANCE CHECKLIST (1): WHAT?

- What is your product? What are your services?
 - Understand your product
 - Does it fall within a control list?



COMPLIANCE CHECKLIST (2): HOW?

- For what will/can your product be used?
 - What is (or could be) the end use that the product is being supplied for?
 - Will the supply be caught by a controlled end use?



COMPLIANCE CHECKLIST (3): WITH WHOM?

- Whom are you supplying to?
 - Who is your customer?
 - Does your customer raise end use concerns?
 - Is your customer a “sanctioned party”?
 - What about other third parties? (subcontractors, affiliates, end users, directors, parent companies, agents, freight forwarders, etc.)



COMPLIANCE CHECKLIST (4): WHERE?

- Where are you supplying to?
 - What country is the customer/end user based in?
 - What intermediary countries are involved?
 - Does this raise end use concerns?



Sanctions – Russian Aspects

I. Risks and Considerations of Russia/Ukraine Sanctions Application (1)

- Russia does not recognize the sanctions applied by U.S., EU and other countries to its citizens and entities
- Termination or suspension of ongoing contracts with Russian SDNs and DPs is viewed in Russia as a breach and entails legal and financial risks:
 - In certain cases – risk of administrative fines for entity and management
 - In certain cases – risk of criminal liability for management
 - In all cases – risk of civil law liability for entity (fines, damages and special performance awards)

I. Risks and Considerations of Russia/Ukraine Sanctions Application (2)

- Foreign law and dispute resolution venue under a cross-border contract between EU entity and the sanctioned Russian entity may mitigate the risks of compliance with sanctions
- Local contract between a Russian subsidiary of EU entity and the sanctioned Russian entity increases those risks:
 - subject entirely to Russian law and dispute resolution
 - Force Majeure is unlikely to be recognized by the Russian Chamber of Commerce and Industry
 - BUT check whether the Russian subsidiary must follow the sanctions (are any EU/US Persons involved?)

I. Risks and Considerations of Russia/Ukraine Sanctions Application (3)

- Inclusion of specific sanction clauses (conditions, restrictions and undertakings), similar to export control clauses and compliance clauses, into all new contracts and (to the extent possible) ongoing contracts with Russian parties is highly recommended:
 - U.S. and EU sanctions against Russian individuals and entities are seen to expand over time, so a permitted deal today may become prohibited by sanctions in the future
 - For major Russian business groups and strategic sectors of economy (e.g. energy, banking) the risk is higher
 - A proper sanction clause improves legal defense in case of a dispute with the sanctioned Russian party for suspension of dealing on those grounds

II. Russian Retaliatory Sanctions/Measures (1)

Presidential Executive Order No. 560 of 6 August 2014 and implemented by Governmental Decree No. 778 dated 7 August 2014

- Ban on imports of specifically listed agricultural and food products originating from the EU, US, Canada, Australia or Norway:
 - Meat and meat products of HS (Harmonized System) codes 0201 - 0203, 0207;
 - Certain types of fish and sea products of HS codes 0302 – 0308;
 - Milk and dairy products of HS codes 0401 – 0406;
 - Certain types of vegetables of HS group 07;
 - Fruit and nuts of HS groups 0801 – 0813;
 - Sausages and similar products of HS code 160100;
 - Certain food products of HS codes 1901 and 2106
- The ban was introduced on 7 August 2014 for a 1-year period
- Exemptions from the above list, effective from 29 August 2014 (Governmental Decree No. 830): fish fries (*Salmo salar* and *Salmo trutta*), lactose-free milk and milk products; sweetcorn hybrids, onion and peas for sowing, seed potato; biologically active supplements, dietary supplements and vitamin-and-mineral complexes

II. Other Russian Retaliatory Sanctions/Measures (2)

Measures against US and Japanese Officials

- Entry ban - 6 US Senators and 3 US President Administration officials' names announced, other names are undisclosed
- Entry ban – some Japanese officials (undisclosed list of 22 August 2014)

Public Statements of Russian officials

- Accusations by Russian authorities of alleged non-compliance of US products/services with the statutory quality/safety/sanitary requirements
- Possible import ban on foreign products
- Ban on use of Russian rocket engines for US military satellites
- Withdrawal from International Space Station operation after 2020
- US GPS - GLONASS ultimatum
- Introduction of a National Payment System
- Restrictions for Western/Ukrainian airlines
- Potential of more substantive response in case of additional sanctions adoption
- Possible challenging of the US, EU and other sanctions in WTO DSB (Dispute Settlement Body)

III. Conclusions and Recommendations

Conclusions

- The sanctions imposed by Russia so far might be only the beginning of a retaliation campaign against the goods and services originating from countries that have imposed Ukraine-related sanctions
- Depending on the political situation in Ukraine, Russia might continue imposing its retaliatory sanctions with respect to the EU, US, Canada, Australia, Japan and Norway

Recommendations

- In order to minimize costs and losses related to the sanctions companies operating in Russia might consider the following steps:
 - Periodically reviewing whether the products at issue by their HS codes or description fall under the list set forth by Decree No. 778 (or other lists if introduced by Russia in the future)
 - Check whether products that are supplied to Russia meet all requirements established by applicable regulations and sanitary measures, in particular, including proper certification/state registration, as well as marking/labeling and packaging requirements



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