King & Spalding

Client Alert

International Trade & Litigation Practice Group

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For more information, contact:

Christine E. Savage
+1 202 626 5541
csavage@kslaw.com

Jeffrey M. Telep
+1 202 626 2390
jtelep@kslaw.com

Iain MacVay
+44 20 7751 2127
imacvay@kslaw.com

Mark T. Wasden
+1 202 626 5529
mwasden@kslaw.com

Jane Y. Cohen
+1 202 661 7842
jcohen@kslaw.com

Sajid Ahmed
+44 20 7551 2128
sahmed@kslaw.com

Shannon Doyle Barna
+1 202 626 5607
sbarna@kslaw.com

Clinton R. Long
+1 202 626 2622
clong@kslaw.com

King & Spalding
Washington, D.C.
1700 Pennsylvania Avenue, NW
Washington, D.C. 20006-4707
Tel: +1 202 737 0500
Fax: +1 202 626 3737

www.kslaw.com

Escalation In Ukraine Leads The United States, EU, Canada, Australia and New Zealand To Respond With Targeted Economic Sanctions

Following a November 2013 decision by the Ukrainian government to suspend preparations for a trade agreement with the European Union, Ukrainians staged massive protests against the government and President Victor Yanukovych that escalated during the early months of 2014. Subsequently, Crimea held a referendum on a proposal to secede from Ukraine and to become part of the Russian Federation, which passed overwhelmingly. On March 21, President Putin signed a law and related legislation for Crimea and the city of Sevastopol to officially become part of the Russian Federation.

The United States, the EU, and certain other nations have not recognized the referendum in Crimea and Russia's actions annexing Crimea as legitimate and responded with targeted sanctions against specific government officials and related persons.

U.S. Response

White House

President Obama issued three Executive Orders in response to Russia's recent actions involving Crimea authorizing the blocking of assets and the imposition of visa bans on identified Russian, Ukrainian, and Crimean government officials and persons with close ties to the Russian government.

- **Executive Order 13660** (March 6, 2014) authorizes the U.S. Departments of State and Treasury to (1) block assets of any persons responsible for or complicit in (A) actions or policies that undermine democratic processes or institutions in Ukraine; (B) actions or policies that threaten the peace, security, stability, sovereignty, or territorial integrity of Ukraine; or (C) misappropriation of state assets of Ukraine or of an economically significant entity in Ukraine; (2) impose sanctions on persons determined to have asserted governmental authority over any part or region of Ukraine without the authorization of the Government of Ukraine; and (3) impose sanction on persons who have "materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of" any activity described above or any person whose assets are blocked pursuant to this Executive Order, as well as those who are "owned or controlled by" or acting "on behalf of, directly or indirectly" any person blocked pursuant to this Executive Order.

- **Executive Order 13661** (March 17, 2014) authorizes the U.S. Departments of State and Treasury to (1) impose sanctions on Russian Government officials and persons operating in the arms or related materiel sector of Russia, and (2) sanction persons who are owned or controlled by, have acted or purported to act for or on behalf of, directly or indirectly, or who have "materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of" a senior official of the Russian Government or a person whose property and interests and property are blocked pursuant to this Executive Order.

- **Executive Order 13662** (March 20, 2014) authorizes the U.S. Departments of State and Treasury to (1) block assets of persons determined to operate in certain economic sectors of the Russian Federation, such as financial services, energy, metals and mining, engineering, as well as defense and related materiel and (2) sanction those who have "materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of" any person blocked pursuant to this Executive Order, as well as those who are "owned or controlled by" or acting "on behalf of, directly or indirectly" any person blocked pursuant to this Executive Order.

All persons that are blocked under the Executive Orders listed above will be identified and listed on the Specially Designated Nationals ("SDN") list that is maintained by the U.S. Department of Treasury's Office of Foreign Assets Control (OFAC). Importantly, OFAC previously issued **guidance** stating that the blocking extends by operation of law to any person in which a person on the SDN list holds a 50 percent or greater ownership interest, either directly or indirectly. Consequently, it is important for companies to perform due diligence on the ownership of the parties involved in their transactions.

If a blocked person has a significant ownership interest that is less than 50 percent, **OFAC's guidance** states the following:

> U.S. persons are advised to act with caution when considering a transaction with a non-blocked entity in which a blocked person has a significant ownership interest that is less than 50% or which a blocked person may control by means other than a majority ownership interest. Such entities may be the subject of future designation or enforcement action by OFAC.

To date, the U.S. Government blocked assets and issued visa bans for 38 individuals, including high-ranking Russian government officials, Russian businessmen with ties to President Putin, former Ukrainian President Yanukovych and his former Chief of Staff, and separatist Crimean officials. President Putin has not been sanctioned.

The U.S. Government has blocked only two entities. On April 11, 2014, OFAC added Chernomorneftegaz, a Crimea-based subsidiary of the Ukrainian state-owned gas company that was seized by the Crimean parliament in March. The U.S. Government also blocked assets of Bank Rossiya, the first Russian financial institution to be targeted, on March 17, 2014. According to news reports, credit card companies initially stopped processing transactions with Russian banks, including with Bank Rossiya, Sobinbank (allegedly owned by Bank Rossiya), and SMP Bank and Investcapitalbank (allegedly owned by blocked persons). In response, President Putin proposed the creation of a Russian National Payment System to process credit card transactions, reducing reliance on foreign payment facilitators. This proposal has already been criticized as too costly and difficult to administer. Certain credit card companies reportedly have since resumed services to SMP Bank and Investcapitalbank.

U.S. Congress

On April 1, 2014, Congress passed the **Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act of 2014** ("Ukraine Act"). President Obama signed the bill into law on April 3, 2014. The Ukraine Act provides for additional foreign aid and loan guarantees to be provided to Ukraine, but it also contains two sections on sanctions. Sections 8 and 9 of the Ukraine Act allow the President to impose sanctions on "persons responsible for violence or undermining the peace, security, stability, sovereignty, or territorial integrity of Ukraine" or persons in the Russian Federation "complicit in or responsible for significant corruption." In essence, these sanctions codify the sanctions imposed by the first two Executive Orders described above. Like the Executive Orders, the Ukraine Act allows the assets of sanctioned persons to be blocked and the exclusion from the United States of such blocked persons. The President has the ability to waive the application of sanctions in the event that the President determines that a waiver "is in the national security interests of the United States."

U.S. Department of State and U.S. Department of Commerce

The U.S. State Department's Directorate of Defense Trade Controls (DDTC) and the U.S. Commerce Department's Bureau of Industry and Security("BIS") placed on hold license applications involving exports and reexports of items subject to U.S. export control licensing requirements to Russia. DDTC has licensing jurisdiction over exports, reexports, and temporary imports of defense articles and defense services under the International Traffic in Arms Regulations. BIS has licensing jurisdiction over exports and reexports of dual-use items under the Export Administration Regulations. BIS also added Chernomorneftegaz to the BIS Entity List, which imposes certain export licensing requirements for transactions with all listed parties.

U.S. Financial Crimes Enforcement Network

On February 25, 2014, the U.S. Financial Crimes Enforcement Network ("FinCEN") published an Advisory, FIN-2014-A001, reminding U.S. financial institutions to take "reasonable, risk-based steps regarding the potential suspicious movement of assets related to Viktor Yanukovych departing Kyiv and abdicating his responsibilities and other senior officials resigning from their positions or departing Kyiv." Such steps include applying enhanced scrutiny to private banking accounts held by or on behalf of senior foreign political figures and monitoring transactions that could potentially represent misappropriated or diverted state assets, the proceeds of bribery of other illegal payments, or other public corruption proceeds. If a transaction appears to have "no business or lawful purpose or has a purpose inconsistent with the customer's known business," then the financial institution is required to file a Suspicious Activity Report with FinCEN. On March 6, 2014, FinCEN issued Advisory FIN-2014-A002, which reiterated the guidance in Advisory FIN-2014-A001 and provided all of the names and identifying information of "former Ukrainian officials and their close associates" that had been sanctioned by the European Union and Canada as of the date of the Advisory.

Additional Sanctions World Wide

European Union

The EU first issued sanctions related to the situation in Ukraine on March 5, 2014 through Council Regulation No 208/2014, which targeted persons identified as "responsible for the misappropriation of Ukrainian State funds" as well as those "responsible for human rights violations in Ukraine." Council Regulation No 208/2014 listed 18 persons who are subject to a travel ban and asset freeze. On March 17, the EU issued Council Regulation No 269/2014, which targeted persons "responsible for actions which undermine or threaten the territorial integrity, sovereignty and independence of Ukraine." This regulation froze the assets of and banned travel by 21 individuals. On March 21, EU leaders announced that they had added 12 new individuals to the list through an amendment to Council Regulation No 269/2014, and on April 15, they announced sanctions against four more individuals under Council Regulation No

208/2014. The EU sanctions apply to all persons and entities doing business in the EU (including nationals of non-EU countries conducting business while in the EU) as well as to EU nationals and entities when doing business outside the EU. Although the individuals sanctioned are not exactly the same as those targeted by the U.S., U.S. government officials have confirmed that the U.S. and the EU are coordinating their efforts when possible.

United Kingdom

In addition to the sanctions at the EU level, the UK has suspended all existing licenses and license applications for direct export to Russia of "military and dual use items destined for units of the Russian armed forces or other state agencies which could be or are being deployed against Ukraine." Further, the UK also has suspended "licenses for exports to third countries for incorporation into equipment for export to Russia where there is a clear risk that the end product will be used against Ukraine."

Australia

On March 19, 2014, Australia imposed asset freezes and visa bans against 12 Russian and Ukrainian individuals found to be "instrumental in the Russian threat to the sovereignty and territorial integrity of Ukraine."

Canada

On March 17, Canada imposed asset freezes and visa bans on ten senior Russian and Ukrainian officials who are active in Crimea, and those who "bear political responsibility" for the escalation in Ukraine. Notably, these sanctions do not include Ukraine's former President Viktor Yanukovych, who Canada had already sanctioned as of February 20, 2014.

New Zealand

New Zealand imposed a travel ban on Russian government officials on March 23. New Zealand government officials have not issued the list of individuals subject to the travel ban, but have indicated that the list contains many of the individuals sanctioned by Australia, the United States, and the EU.

Japan

On March 18, Japan announced that it was suspending talks between Japan and Russia on a number of topics, including a relaxing of visa requirements between the two countries, space exploration, and military cooperation.

What To Expect Next

The United States and the EU are taking steps to isolate Russia internationally. For example, on March 24, G8 leaders **voted to end Russia's role** in the G8 group of industrialized countries. Russia had been a member of the G8 since 1998. The remaining leaders will continue to meet as the G7 and will hold a summit without Russia this summer.

In addition, President Obama has been advocating for Europe to decrease its dependence on Russia as a source of energy. This comes at a time when the United States and the EU are currently negotiating the Transatlantic Trade and Investment Partnership (TTIP), pursuant to which the United States committed to increasing exports of natural gas to Europe. Also, Executive Order 13662 provides the regulatory groundwork for additional sanctions against Russia's energy sector. As such, the U.S. Government may impose additional sanctions on companies operating in Russia's oil and gas industry and possibly on financial services providers. The EU already took a step in this direction and on April 17, the European Parliament passed a **joint motion for a resolution** ("Join Motion") calling for an imposition of "measures" targeting, "Russian companies and their subsidiaries, particularly in the energy sector, as well as Russian investments and assets in the EU, and for all agreements with Russia to be reviewed with a view to their possible suspension." The Joint Motion also calls for an immediate imposition of economic sanctions against Russia and of an "arms and dual-use technology embargo."

Notably, Russia and Iran are working towards a barter deal which would allow Russia to obtain Iranian oil in exchange for equipment and goods. **Sources** report that the deal may be worth up to $20 billion and may involve up to 500,000 barrels of Iranian oil per day. Such a deal between the two countries could undermine the agreement reached in January 2014 between Iran and other world powers regarding Iran's nuclear program, and would likely result in additional sanctions against both Iran and Russia.

If you have any questions about the Ukraine related sanctions, the authors would be pleased to assist you.

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