

CLIENT ALERT

Enforcing the Peace: The U.S. and EU Sharply Expand Sanctions and Export Restrictions on Russia

September 12, 2014

Having given the ceasefire agreement one week to work, the United States and European Union issued comprehensive expanded sanctions on September 12, 2014. These coordinated measures expand sectoral sanctions to the Russian oil and defense sectors, expand export prohibitions, reduce the allowable credit period, target participation in oil exploration within Russia, and designate dozens of new persons. Each of these changes is discussed below.

UNITED STATES

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) issued new sectoral and blocking sanctions in coordination with new export control prohibitions issued by the U.S. Commerce Department's Bureau of Industry and Security (BIS).

Sectoral Sanctions: OFAC updated its sectoral sanctions in a variety of ways:

- **New Designations:** the United States added seven new entities to its sectoral sanctions identifications list (SSI): AK Transneft OAO (Directive 2); Lukoil OAO (Directive 4); OJSC Gazprom Neft (Directives 2 and 4); OJSC Gazprom (Directive 4); Rostec (Directive 3); Sberbank of Russia (Directive 1); Surgutneftegas (Directive 4).
- **Revisions to Existing Prohibitions (90 Days to 30 Days):** The United States reduced the period from 90 to 30 days for the provision of debt or equity for entities listed on Directive 1 (financial firms) and Directive 3 (Rostec). This does *include* payment terms in excess of 30 days. This change does not affect entities listed on Directive 2.
- **New Additions to Existing Prohibitions (Directive 1 and Directive 2):** The United States added Sberbank – Russia's largest bank – to Directive 1. U.S. persons are prohibited from transactions in new debt with a maturity of longer than 30 days or new equity of persons identified on Directive 1. OFAC also added Transneft and Gazprom Neft to Directive 2. U.S. persons are prohibited from transactions in debt of longer than 90 days of persons identified on Directive 2.
- **New Defense Related Prohibitions – New Directive 3:** The United States created Directive 3 to target certain persons operating in the Russian defense and related material sectors. Directive 3 prohibits the extension of new debt with a maturity greater than 30 days to listed persons. The only designation under Directive 3 is Rostec.
- **New Oil Exploration Prohibitions – New Directive 4:** The United States created a new form of sectoral sanctions targeting entities on Directive 4. OFAC prohibits the export or re-export of goods, services (but *not* financial services), or technology to the following entities "in support of exploration or production for deepwater, Arctic offshore, or shale projects that have the potential to produce oil in the Russian Federation" or in Russian territorial waters: Gazprom Neft; Gazprom; Lukoil; Rosneft; and Surgutneftegaz.

- **New General Licenses:** Simultaneously, OFAC issued two General Licenses (GL). First, OFAC issued a General License No. 1 to authorize transactions involving derivatives whose value is linked to an underlying asset that constitutes prohibited debt or equity. Second, OFAC issued General License No. 2 which authorized transactions "ordinarily incident and necessary to the wind down" of operations with persons subject to Directive 4 that are undertaken before 12:01 AM on September 26, 2014. GL 2 imposes a reporting obligation for transactions undertaken under the GL.
- **New FAQs:** Finally, OFAC issued a revised set of Frequently Asked Questions related to the Sectoral Sanctions. These primarily reflect revisions to reflect the new payment terms, the new Directives (3 & 4), and several clarifications related to particular types of transactions.

New OFAC Designations: OFAC added the following five state-owned defense technology firms to its SDN List subject to its typical blocking prohibitions:

- JOINT STOCK COMPANY ALMAZ-ANTEY AIR DEFENSE CONCERN MAIN SYSTEM DESIGN BUREAU NAMED BY ACADEMICIAN A.A. RASPLETIN
- JSC V. TIKHOMIROV SCIENTIFIC RESEARCH INSTITUTE OF INSTRUMENT DESIGN
- KALININ MACHINE PLANT JSC
- MYTISHCHINSKI MASHINOSTROITELNY ZAVOD, OAO
- OAO 'DOLGOPRUDNY RESEARCH PRODUCTION ENTERPRISE'

Coordinated Export Control Prohibitions: Simultaneously, BIS issued coordinated export control requirements. First, it added the five new SDNs designated by OFAC to its Entity List, thus prohibiting the unlicensed export, reexport or transfer of items subject to the Export Administration Regulations to these persons.

Second, it imposed a licensing requirement on the export, reexport, or transfer of any item subject to the EAR when the person knows those items are to be used directly or indirectly in the "exploration for, or production from, deepwater, Arctic offshore, or shale projects in Russia" for the five oil firms identified by OFAC on Directive 4.

EUROPEAN UNION

The European Union finally published a sanctions package to which member states had agreed on Monday, September 8th. The new measures include four main components, similar to but not identical with those announced by the United States: expanded sectoral sanctions, new blocking designations, additional export control prohibitions, and a new ban on joint participation in oil exploration. These sanctions will be "reviewed" by the EU at the end of the month.

Sectoral Sanctions: The EU expanded its sectoral sanctions which prohibit the provision of "investment services" (see below) and dealing in "transferable securities and money-market instruments" (see below) in several ways.

- **Extension to Defense Companies:** First, the EU extended sectoral sanctions to three entities that the EU determined are "predominantly engaged and with major activities in the conception, production, sales or export of military equipment

or services." (Art. 5(2)(a)): OPK Oboronprom; United Aircraft Corporation; and Uralvagonzabod. (Annex V). These restrictions flow to any entities that are 50 percent or more owned by these designated entities or acting on their behalf. (Art. 5(2)(c)-(d)).

- **Extension to Oil Companies:** Second, the EU extended sectoral sanctions to three Russian legal entities that are "publicly controlled with over 50% public ownership and having estimated total assets of over 1 trillion Russian Roubles and whose estimated revenues originate for at least 50% from the sale or transport of crude oil or petroleum products." (Art. 5(2)(b)): Rosneft; Gazprom Neft; and Transneft. These restrictions flow to any entities that are 50 percent or more owned by these designated entities or acting on their behalf. (Art. 5(2)(c)-(d))
- **Reduction of Credit Terms:** The EU reduced the time period for financial instruments to 30 days from 90 days for credit issued after September 12, 2014. The EU continued its view that payment terms are not considered to be an extension of credit).
- **Changing "Brokering" to "Investment Services":** The EU changed its definitions to now target "investment services" rather than "brokering." However, the contents of the definition remained identical, just the term changed. So, now the EU prohibits persons to "directly or indirectly purchase, sell, [or] provide investment services" for sectorally sanctioned entities.

Blocking Designations: Second, the EU expanded its traditional blocking sanctions in two ways:

- The EU added a new criteria for designations: "natural or legal persons, entities or bodies conducting transactions with the separatist groups in the Donbass region of Ukraine."
- The EU also newly designated 24 individuals, primarily politicians in the rebel-controlled areas of Eastern Ukraine, Moscow-based politicians who have supported the rebels, and Sergey Chemezov chairman of Rostec (and already designated by the U.S.).

Prohibition on EU Participation in Oil Exploration: Third, the EU added a new prohibition on EU persons participation in "(i) drilling, (ii) well testing, (iii) logging and completion services, (iv) supply of specialized floating vessels" that is "necessary for deep water oil exploration and production, arctic oil exploration and production, or shale oil projects in Russia." (Art. 3a(1)). Pre-existing contracts are grandfathered (Art. 3a(3)).

Full Dual-Use Ban on Nine New Entities: Finally, the EU extended its export control prohibitions, prohibiting the sale, supply, transfer, or export of EU dual-use goods or technology to the following nine entities servicing the Russian military:

- JSC Sirius (optoelectronics for civil and military purposes);
- OJSC Stankoinstrument (mechanical engineering for civil and military purposes);
- OAO JSC Chemcomposite (materials for civil and military purposes);
- JSC Kalashnikov (small arms); JSC Tula Arms Plant (weapons systems);
- NPK Technologii Maschinostrojenija (ammunition);
- OAO Wyssokototschnye Kompleksi (anti-aircraft and anti-tank systems);
- OAO Almaz Antey (state-owned enterprise; arms, ammunition, research); and
- OAO NPO Bazalt (state-owned enterprise, production of machinery for the production of arms and ammunition)'.

Pre-existing contracts are grandfathered (Art. 2a(3)) and the prohibitions do not apply to the aeronautics and space industry (Art. 2a(4)). The EU and United States sanctions on Russia are changing rapidly.

* * *

Please refer to the authors below or your regular Crowell & Moring contact for additional questions regarding these changes and any potential impact they may have.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Alan W. H. Gourley

Partner – Washington, D.C.

Phone: +1.202.624.2561

Email: agourley@crowell.com

David (Dj) Wolff

Partner; Attorney at Law – Washington, D.C., London

Phone: +1.202.624.2548, +44.20.7413.1368

Email: djwolff@crowell.com