Client Update

U.S. and EU Continue to Expand Ukraine-related Sanctions and Clarify Sanctions Targeting Russian Companies

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In the last month of 2014, the United States and European Union expanded sanctions against Russia:

New U.S. and EU Sanctions on Crimea

- On December 19, 2014, President Obama issued Executive Order (E.O.) 13685, authorizing new blocking sanctions and trade restrictions targeting Russia-annexed Crimea, and OFAC designated a further 24 individuals and entities for supporting or engaging in separatist activities in Ukraine.
- On December 18, 2014, the European Union published Council Regulation (EU) 1351/2014 ("Regulation 1351"), which extends the EU's sanctions against Crimea and Sevastopol set out in Regulation (EU) 692/2014.

Clarification of Existing Sanctions Targeting Russian Companies

- On December 11, 2014, the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") issued three new Frequently Asked Questions ("FAQs") clarifying existing provisions of the so-called "sectoral sanctions" imposed on Russian companies designated on OFAC's Sectoral Sanctions Identifications ("SSI") list.
- On December 5, 2014, the European Union published Council Regulation (EU) 1290/2014 ("Regulation 1290"), which introduced a number of amendments and clarifications to the EU trade and financial sanctions concerning Russia set out in Council Regulation (EU) 833/2014 (as amended by Council Regulation (EU) 960/2014, "Regulation 833"). The EU sanctions imposed under Regulation 833 include restrictions that are similar, but not identical, to the U.S. sectoral sanctions.

- On December 16, 2014, the European Commission published the Commission Guidance note on the implementation of certain provisions of Regulation 833 (the "Commission Guidance Note"), which provides a number of clarifications on the scope and application of the EU's financial and capital market sanctions. It should be noted that the Commission Guidance Note only sets out the European Commission's understanding of Regulation 833 and does not create any new legislative rules, as only the Court of Justice of the EU is able to provide legally binding interpretations of EU law. In this respect, while the Commission Guidance Note is likely to be treated as persuasive, there is a possibility that EU courts will adopt alternative interpretations of Regulation 833.

Authorization of New Sanctions on Russia

- On December 18, 2014, President Obama signed into law the Ukraine Freedom Support Act of 2014 ("UFSA") (Public Law No. 113-272), which authorizes expanded sanctions on Russia.
- In a statement, President Obama indicated that his Administration does not intend to impose new sanctions under the law at this time.

For additional information on the U.S. and EU sanctions on Russia, please see our Sanctions Alert Issue 24 and Issue 27.

NEW U.S. AND EU RESTRICTIONS RELATING TO CRIMEA

United States

E.O. 13685 authorizes new targeted blocking sanctions (asset freezes) on any person operating in Crimea as well as requires U.S. persons to comply with comprehensive trade restrictions on the entire region.

The Secretary of the Treasury, in consultation with the Secretary of State, is now authorized to impose blocking sanctions on any person determined:

- To operate in Crimea;
- To be a leader of an entity operating in Crimea;
- To be owned or controlled by, or to have acted for or on behalf of, a person designated under E.O. 13685; or
- To have provided material support to any person designated under E.O. 13685.

No persons have yet been designated pursuant to E.O. 13685, but Russian companies active in Crimea could be targeted in the future.

The comprehensive trade restrictions on Crimea now prohibit:

- New investment in Crimea by a U.S. person;
- Importation into the United States, directly or indirectly, of any goods, services or technology from Crimea;
- The exportation, reexportation, sale or supply, directly or indirectly, from the United States or by a U.S. person of any goods, services or technology to Crimea; and
- Approval, financing, facilitation or guarantee by a US person of any transaction by non-U.S. persons that would be prohibited under the E.O. if performed by a U.S. person or within the States.

U.S. exporters to Russia should consider implementation of effective safeguards to ensure that products delivered to Russian distributors are not destined for Crimea.

Concurrent with the signing of E.O. 13685, OFAC issued Ukraine-related General License 4, which generally authorizes the exportation or reexportation to Crimea of agricultural commodities, medicine, medical supplies and replacement parts for medical devices that would otherwise be prohibited by E.O. 13685.

On December 30, 2014, OFAC issued Ukraine-related General License 5, which provides a "winding down" period for E.O. 13685's trade restrictions through the end of January 2015. The winding down period is limited to investments and import or export agreements in effect on December 20, 2014, and it does not allow any new exports from the United States to Crimea or any new imports into the United States from Crimea except as needed to wind down existing operations or agreements.

European Union

Regulation 1351 substantially extends the existing EU sanctions against Crimea and Sevastopol and restricts the ability of EU persons to invest in or trade with entities based in this territory. New restrictions include prohibitions on:

- Investment in real estate located in Crimea or Sevastopol;
- Investment in entities located in Crimea or Sevastopol, or entering into joint ventures with such entities;

- Providing loans, credit or financing to entities located in Crimea or Sevastopol;
- Providing investment services directly related to any of the above activities; and
- Providing services related to tourism activities in Crimea or Sevastopol, including through cruise ships entering into ports in the Crimean peninsula.

Unlike the United States, the European Union has not imposed a comprehensive ban on all trade with Crimea; however, Regulation 1351 extends the prohibition on the sale, supply, transfer or export of goods relating to the transport, telecommunication, energy and oil, gas and mineral industries (the "Restricted Industries") in Crimea or Sevastopol through the introduction of a broader list of prohibited goods. Technical assistance, brokering, construction and engineering services relating to the Restricted Industries are also now prohibited.

The new prohibitions in Regulation 1351 are subject to grandfathering provisions which allow the execution of obligations arising out of contracts concluded before December 20, 2014. In the case of the new prohibitions relating to the Restricted Industries, however, these grandfathering provisions only allow execution of otherwise restricted obligations up until March 21, 2015.

UPDATES REGARDING EXISTING U.S. AND EU RESTRICTIONS ON PROVIDING FINANCE TO DESIGNATED RUSSIAN COMPANIES

United States

Under Directive 1 of the SSI list, U.S. persons may not finance or otherwise transact or deal in new equity or debt of longer than 30 days' maturity of designated Russian financial institutions. Under Directive 2, U.S. persons may not transact in new debt of longer than 90 days' maturity issued by designated Russian energy companies. Directive 3 prohibits U.S. persons from transacting in debt of longer than 30 days' maturity issued by Rostec, a defense company (the only one currently designated).

New OFAC FAQ #419 provides the following clarifications and guidance regarding the Directives' restrictions on debt financing:

- In a sale of goods to an SSI entity, payment terms may extend up to either 30 or 90 days (depending on the Directive applicable to the SSI entity) from the point at which title or ownership of the goods transfers to the SSI entity.
- Payment terms for the provision of services, subscription arrangements, and progress payments for long-term projects may extend up to 30 or 90 days, as

relevant, from the point at which a final invoice (or each final invoice) is issued.

- If a U.S. person believes that full payment from the SSI entity may not be received within the 30- or 90-day period, as relevant, the U.S. person should contact OFAC to inquire whether a license or other authorization would be required.

European Union

Two significant developments have occurred in relation to the EU's financial restrictions, first set out in Regulation 833. First, Regulation 1290 implements a number of amendments and clarifications to Regulation 833, including a new exemption for certain payments under multi-tranche loans. Second, the Commission Guidance Note provides guidance in relation to a number of frequently asked questions about the scope and application of the financial restrictions.

Multi-tranche Loan Exemption

Article 5(3) of Regulation 833 prevents persons required to comply with EU sanctions from making or being part of any arrangement after September 12, 2014, to make available new loans or credit with a maturity exceeding 30 days (the "Loan Restriction") to certain designated Russian banking, defense and oil industry entities and their non-EU subsidiaries ("Designated Entities").

The prohibition is subject to a number of specific exemptions. Regulation 1290 has now introduced an additional exemption, relating to loans to a Designated Entity under a revolving or multi-tranche credit facility entered into before September 12, 2014. Tranches of such facilities can be extended after September 12, 2014, provided that:

- The terms and conditions applicable to post-September 12, 2014, drawdowns (including the maximum amount, interest rate calculation method and repayment period) were agreed before September 12 and have not been modified since then; and
- The facility was, before September 12, 2014, subject to a contractual maturity date by which all funds must be repaid and all rights and obligations created by the agreement must expire.

This exemption is likely to provide some assurance to Designated Entities, as it was previously unclear as to whether new drawdowns under existing facilities would be classed as restricted "new loans or credit" for the purposes of Regulation 833.

Commission Guidance Note Clarifications on the EU's Loan Restriction

The Commission Guidance Note provides clarifications in relation to three broad categories of questions arising from the EU's Loan Restriction:

1) Trade Finance

Under Regulation 833 (as amended by Regulation 1290), one of the Loan Restriction's exemptions allows the provision of a loan or credit to a Designated Entity where the loan or credit has the specific and documented objective of providing financing for non-prohibited imports or exports of goods and non-financial services between the EU and any third country.

The Commission Guidance Note sets out a number of clarifications in relation to this exemption:

- Third country content may be included in goods or services being imported into or exported out of the EU for the purposes of the exemption, provided that expenditure on such third country goods or services is necessary for the underlying import or export.
- The exemption can apply where goods transit between third countries, provided that the relevant contract clearly stipulates that the imports are destined for, or the exports originate in, the EU.
- The "third countries" referred to in the exemption include Russia.
- Financing for trade taking place purely between two non-EU countries is not eligible for the exemption.
- Discounting or post-financing a letter of credit with a maturity of more than 30 days issued by a Designated Entity for trade between two non-EU countries would constitute extending credit to the issuing Designated Entity and so would be prohibited.
- The exemption does not apply to transferable securities or financial instruments issued by Designated Entities.

2) Emergency Funding

Regulation 833 (as amended by Regulation 1290) includes an exemption for loans that have a specific and documented objective to provide emergency funding to meet solvency and liquidity criteria for EU subsidiaries of Designated Persons. The Commission Guidance Note states that "emergency funding" should be read as applying in situations such as those set out in Article 32(4) of

EU Directive 2014/59/EU: the circumstances in which the EU deems a financial institutional as failing or likely to fail.

3) Loan Restriction Scope

The Commission Guidance Note also includes clarifications in relation to the scope of the Loan Restriction:

- The Loan Restriction does not apply to deposit services, including term deposits with a maturity exceeding 30 days. However, it should be noted that a loan disguised as a deposit could trigger Regulation 833's anti-circumvention provisions.
- "Payment terms" and delayed payments exceeding 30 days do not fall within the scope of the Loan Restriction, though the Commission warned against their use to circumvent the restriction, stating that the EU would consider whether the payment terms or delayed payments were in line with normal business practice or had been substantially extended since September 12, 2014, when assessing whether they amounted to circumvention.
- A creditor may assign a loan or credit issued to a Designated Entity with a maturity exceeding 30 days without breaching the Loan Restriction, provided that the loan or credit was originally issued before September 12, 2014. However, a Designated Entity may not take over an existing loan or credit with a maturity exceeding 30 days, even if that loan or credit was issued before September 12, 2014, as this would constitute making a new loan or credit to such a designated entity.
- Payment and settlement services, including through correspondent banking, are not prohibited by the Loan Restriction.

Commission Guidance Note Clarifications on the EU's Capital Market Restrictions

Regulation 833 also prohibits persons from purchasing, selling, providing investment services for or assisting in the issuance of, or otherwise dealing with transferable securities and money-market instruments with a maturity exceeding 30 days, issued by Designated Entities after September 12, 2014 (the "Capital Market Restriction"), or exceeding 90 days and issued by certain Designated Entities between August 1, 2014, and September 12, 2014.

The Commission Guidance Note provides a number of helpful clarifications in relation to the Capital Market Restriction:

- Dealing with derivatives which grant the right to acquire or sell a transferable security or a money market instrument otherwise caught by the

Capital Market Restriction is prohibited. However, interest rate swaps, credit default swaps, cross currency swaps and derivatives used in the energy market for hedging purposes, are not covered by the prohibition.

- Depositary receipts relating to Designated Entities are subject to the Capital Market Restriction if (i) they relate to transferable securities issued by a Designated Entity after August 1, 2014 (or September 12, 2014, in certain cases), or (ii) the depositary receipts are issued under a deposit agreement entered into with a Designated Entity after August 1, 2014 (or September 12, 2014), even if the underlying securities were issued before the relevant date.
- A Designated Entity may act as a custodian for depositary receipts of non-sanctioned entities.
- Persons subject to EU sanctions may not use transferable securities or money market instruments subject to the Capital Market Restriction as collateral in repurchase agreements or securities lending agreements. In addition, repurchase agreements and securities lending agreements are themselves money market instruments and so the Capital Market Restriction prevents persons from entering into such agreements with Designated Entities.
- If a Designated Entity has transferable securities which are fungible with restricted transferable securities issued after August 1, 2014 (or September 12, 2014), the onus is on the person dealing with such transferable securities to ensure that it does not enter into transactions which involve the restricted transferable securities. However, the Commission Guidance Note does not provide any practical recommendations as to what steps a person subject to EU sanctions should take in order to ensure that this onus is discharged.

UPDATES REGARDING EXISTING EU RESTRICTIONS ON PROVIDING FINANCIAL ASSISTANCE FOR PROHIBITED TRADE

As part of the trade restrictions set out in Regulation 833, the EU prohibits a person from providing financial assistance for the sale, supply, transfer or export of military goods, certain dual-use goods and certain oil industry equipment for use in Russia. While the term “financial assistance” is not defined in Regulation 833, the Commission Guidance Note has provided two useful clarifications:

- The provision of payment services or issuance of letters of credit or guarantee would constitute “financial assistance” for the purposes of this restriction.
- Banks are required to exercise due diligence on client transactions and should not allow any payment relating to transactions which are prohibited by

Regulation 833. Correspondent banks are also expected to halt payments where information is available that a payment relates to any such breaches.

UPDATES REGARDING EXISTING U.S. AND EU RESTRICTIONS ON RUSSIA'S ENERGY SECTOR

United States

Directive 4 of the SSI list targets the supply of goods, services and technology to certain companies in Russia's oil industry. Specifically, U.S. persons are prohibited from exporting to certain companies goods, services (not including financial services) or technology in support of exploration or production for Russian deepwater, Arctic offshore or shale projects that have the potential to produce oil. The targeted companies under Directive 4 are Gazprom, Gazprom Neft, Lukoil, Surgutneftegas and Rosneft.

In OFAC FAQ #420, OFAC defines "production" of oil as "the lifting of oil to the surface and the gathering, treating, field processing, and field storage of such oil." OFAC notes that "production" ends, for purposes of Directive 4, when oil extracted from a deepwater, Arctic offshore or shale project is "transported out of a field production storage tank or otherwise off of a field production site." Consequently, activities such as transportation and refining are not prohibited to U.S. persons if they involve oil that has already been removed from a field production storage tank or otherwise transported off a field production site.

In OFAC FAQ #421, OFAC states that to be a prohibited "Arctic offshore project," the project must both (i) involve drilling operations originating offshore and (ii) be located above the Arctic Circle. Horizontal drilling originating onshore, even where such drilling extends under the seabed to areas above the Arctic Circle, is not prohibited.

European Union

Article 3(1) of Regulation 833 implements a requirement for persons to obtain authorization before selling, supplying, transferring or exporting certain oil-industry related equipment (such as certain types of piping or mobile drilling derricks) for use in Russia. Such authorization cannot be granted if the equipment will be used for deep water oil exploration and production, Arctic oil exploration and production or shale oil projects in Russia ("Restricted Oil Projects"). Further, Article 3a(1) of Regulation 833 prohibits persons from providing certain oil industry-related services (such as drilling or well testing) for Restricted Oil Projects. Unlike the U.S. sanctions, these restrictions relate to all exports to or for use in Russia, not just those in connection with certain named companies.

Regulation 1290 has introduced two important clarifications to these restrictions.

First, the restrictions now expressly apply to projects taking place in Russia's Exclusive Economic Zone and on its Continental Shelf as well as within Russia proper.

Second, the EU has replaced the terms denoting Restricted Oil Projects with more descriptive phrases:

- "deep water" has been replaced by "waters deeper than 150 metres";
- "Artic" has been replaced by "the offshore area north of the Arctic Circle"; and
- "shale oil projects " has been replaced by "projects that have the potential to produce oil from resources located in shale formations by way of hydraulic fracturing."

The EU also clarified that exploration and production through shale formations to locate or extract oil from non-shale reservoirs is not subject to the same restrictions as the above categories.

Prior to the introduction of Regulation 1290, the degree of uncertainty in the wording of these restrictions was highlighted by an unsuccessful attempt by Rosneft in the High Court of England to suspend the UK's implementation of legislation criminalizing breaches of these restrictions. Rosneft had argued, in part, that the meaning of the terms "deep water", "Arctic" and "shale" was so uncertain as to have either no ascertainable meaning or be so unclear in its effect as to be incapable of certain application in any case.

THE UKRAINE FREEDOM SUPPORT ACT OF 2014

The UFSA authorizes the expansion of existing U.S. sanctions that target companies in and activities involving Russia's defense and energy sectors. The USFA also authorizes new sanctions against non-U.S. financial companies that facilitate and support related transactions. Among other provisions, the sanctions set out in the UFSA include:

- Imposing sanctions on Rosoboronexport, Russia's state-owned agency for defense-related imports and exports;

- Authorizing sanctions on entities owned or controlled by the Russian government or Russian nationals that sell or transfer defense articles into certain countries, including Syria, Ukraine, Georgia and Moldova, and any foreign person that assists in such sales or transfers of defense articles into these countries;
- Authorizing sanctions on any foreign person that makes a significant investment in certain Russian crude oil projects; and
- Prohibiting foreign financial institutions that facilitate certain transactions involving Russia's defense and energy sectors or any Russian person on the Specially Designated Nationals ("SDN") list from opening or maintaining correspondent or payable-through accounts in the United States.

With respect to the provisions relating to Russia's energy and defense sectors, the USFA authorizes three or more of the following sanctions to be imposed on any foreign person found to engage in the targeted activities:

- Prohibition on support from the U.S. Export-Import Bank;
- Prohibition on entering into procurement or supply contracts with U.S. executive agencies;
- Prohibition on arms exports from the United States;
- Prohibition on dual-use exports from the United States;
- Imposition of limited or full blocking sanctions;
- Prohibition of transfers of credit or payments in which the designated person has an interest;
- Prohibition on U.S. persons' transacting or otherwise dealing in the designated person's long-term debt or equity; or
- Imposition of travel bans on designated individuals.

The USFA allows any of these sanctions to be imposed on the executive officers of designated companies.

There are a number of exceptions authorized under the USFA. In general, sanctions imposed under the USFA would not apply to the importation of goods into the United States, even where a sanctioned person has an interest in such goods. On a case-by-case basis, the President is authorized to make exceptions for the procurement of certain defense articles and services and where the waiver of sanctions would be in the national security interest of the United States.

The final version of the USFA signed into law was not as far-reaching as the initial version approved by the Senate Foreign Relations Committee in September 2014 and likely will not have a major effect on U.S.-Russia trade. In signing the UFSA into law, President Obama indicated that his Administration does not intend to impose new sanctions under the law at this time but noted that "the Act gives the Administration additional authorities that could be utilized, if circumstances warrant."

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