Latest Russia Sanctions Ratchet Up Risks of Doing Business in Russia - Including for Non-U.S. Companies

05.23.2018

On April 6, 2018, the Office of Foreign Assets Control (?OFAC?) designated thirty-eight additional Russian parties for sanctions under the Russia/Ukraine sanctions program, including seven Russian ?oligarchs,? twelve companies, seventeen Russian government officials, a state-owned weapons company and a Russian bank. This marks a significant expansion of the Russia sanctions program and creates a heightened level of risk for companies doing business in Russia.[1]

While OFAC had previously designated a number of Russian parties for sanctions, many of these were under the ?sectoral sanctions? program that only restricted limited types of business activities with targeted parties.[2] The latest designations ? listing parties on the List of Specially Designated Nationals and Blocked Persons (the ?SDN List?) ? represents a higher level of sanctions restrictions and a ratcheting up of the Russia sanctions program.

When a party is listed on the SDN List, U.S. persons are prohibited from entering into effectively all business transactions with the listed party, with limited exceptions, and are required to block the targeted parties? assets that come within their possession. In addition, if one or more parties on the SDN List own 50% or more of an entity such as a company or LLC, the entity is considered to be blocked as well even if it is not actually listed on the SDN List and U.S. parties are prohibited from entering business transactions with such entity. OFAC has also advised that foreign persons could face ?secondary? sanctions for knowingly facilitating significant transactions for or on behalf of the parties that have been designated (discussed further below).

Many of the parties designated in the recent round of sanctions are prominent politically-connected Russian business executives who have substantial holdings in major Russian companies. Since the SDN designations also restrict entering transactions with companies that are 50% or more owned by the SDN?s, the new sanctions restrict business transactions across a wide area of the Russian economy. This was reflected in a significant drop in the Russian stock market and the price of the ruble following the announcement of the sanctions. Russian companies affected include RUSAL PLC, EN+ Group

PLC, Renova Group and GAZ Group.

For U.S. companies operating in Russia, this raises the complex issue of trying to determine who the shareholders are of companies with whom you are dealing and ways to avoid inadvertently entering transactions with restricted companies.

The new sanctions are in addition to previously existing Russia/Ukraine restrictions that were imposed by OFAC and the Bureau of Industry and Security (?BIS?) which include:

1. Restrictions on dealing with other Russian and Ukrainian parties that are listed in earlier designations on the SDN List and entities in which these persons have a 50% or greater ownership interest;
2. Restrictions on entering certain prohibited transactions with Russian parties in the energy, banking and defense industries under the OFAC ?sectoral sanctions? under Executive Order 13662 and the Directives promulgated thereunder;
3. The prohibition against dealing in effectively any business transactions involving the Crimea region of Ukraine under Executive Order 13685 and §746.6 of the Export Administration Regulations (?EAR?);
4. Restrictions on exporting certain specified products to Russia if the item will be used directly or indirectly in the exploration for, or production of, oil or gas in Russian deepwater or Arctic offshore locations or shale formations (or you are unable to determine whether the item will be used in such projects) under the BIS Russian Industry Sector Sanctions set forth at 15 CFR §746.5;
5. Restrictions on dealings with certain Russian parties designated on the BIS Entity List under the ?End-Use and End-User Based Controls? at 15 CFR §744.10;
6. Restrictions on exporting certain products to Russia if the exporter has ?knowledge? that the item is intended for a ?military end use? or ?military end user? in Russia under 15 CFR §744.21; and
7. Restrictions on the export of any 600 series or 9x515 items (including items described in a .y paragraph) to Russia without a license under 15 CFR §744.21.

OFAC also announced that the new sanctions apply to non-U.S. companies in certain instances. Specifically, non-U.S. companies can be sanctioned under secondary sanctions for knowingly facilitating significant transactions with parties designated as SDN?s. Thus if a non-U.S. company enters a significant transaction which is viewed by OFAC as ?facilitating? business with someone listed on the SDN List, the non-U.S. company runs the risk of being placed on the SDN List itself. This issue was addressed in the Treasury Department?s April 6, 2018 press release issued simultaneously with the issuance of the new sanctions: *?Additionally, non-U.S. persons could face sanctions for knowingly facilitating significant transactions for or on behalf of the individuals or entities blocked today.?*[3]

OFAC has issued a number of general licenses to permit companies to ?wind down? certain business dealings with parties designated under the April 6 sanctions during a limited period of time subject to a number of conditions. These include Ukraine-Russia related General License 12,[4] 12A,[5] 12B,[6] 12C, 13,[7] 13A, 14 and 15.

In light of the growing number of Russian companies that are subject to sanctions, many U.S. and non-U.S. companies will now be using a higher level of care in their business dealings in Russia, Ukraine and the surrounding region. For U.S. companies this can include being mindful of the seven categories of restricted activities identified above as well as avoiding trade and other business transactions that are financed by Russian banks that have been designated on the SDN List. In addition, many U.S. companies will be using increased scrutiny involving transactions that present the risk of improper diversion, i.e., where the U.S. company sells its product to a company in the region that is not designated for sanctions, and this party resells the product to a company that is on the SDN List. Similarly, many companies are using increased scrutiny for entities that could be ?shell? or front companies that are set up and indirectly controlled by SDN?s to evade sanctions.

Many non-U.S. companies will now also be using heightened levels of care in their dealings with Russian companies ? especially activities that could be viewed as facilitating significant transactions with restricted Russian parties and taking other steps to avoid ?secondary? U.S. sanctions. Questions that many non-U.S. companies will now be asking themselves include: (i) is your company doing business with a company listed as an SDN or that is owned 50% or more by SDN?s? (Note that many subsidiaries of Russian companies operate in Europe, Asia, the U.S. and other foreign countries.) Does your company have shareholders that are SDN?s? Does your company own shares in SDN companies or their subsidiaries? Are officers and/or directors SDN?s?

There are a variety of compliance practices that U.S. and foreign companies can deploy for addressing these issues and to help reduce potential liabilities.

When OFAC imposes sanctions on a foreign country, it often starts by designating a few persons or entities in the country. If the country does not cooperate, the sanctions can be expanded to cover a wider net of individuals, companies and restrictions, and sometimes secondary sanctions, and can ultimately lead to a total economic embargo. This is the significance of the April 6 Russia designations ? OFAC is gradually expanding the Russia program from narrowly targeted restrictions to having a broader impact on the Russian economy. How far this will go is anyone?s guess. Notwithstanding, companies should recognize the complex and hazardous export compliance environment for dealing in Russia, Ukraine and the surrounding region and protect themselves when operating in these environments.

[1] The designations were made pursuant to Executive Orders 13661, 13662 and 13582 and the Countering America?s Adversaries Through Sanctions Act (?CAATSA?) following the Treasury Department?s issuance of the CAATSA Section 241 Report which listed Russian ?oligarchs.?

[2] Under Executive Order 13662 of March 20, 2014 OFAC issued

four directives which prohibit certain financial and other transactions with Russian parties listed on OFAC?s Sectoral Sanctions Identification List in the energy, banking and defense sectors.
[3] In addition, OFAC addressed the issue of sanctions on non-U.S. companies in ?Frequently Asked Question? No. 574 issued simultaneously with the issuance of the new sanctions.
[4] General License 12 has been superseded and replaced by General License 12A.
[5] General License 12A has been superseded and replaced by General License 12B.
[6] General License 12B has been superseded and replaced by General License 12C.
[7] General License 13 has been superseded and replaced by General License 13A.

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