Russia Sanctions

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Segall: 2014 has been a challenging year in U.S.-Russia relations. Due to Russian involvement in Ukraine going back to early March, the U.S., the EU and a number of other countries imposed sanctions on Russia. Three executive orders since that time have progressively ratcheted up the severity of sanctions as they affect Russia and certain parts of Ukraine, calibrated to the U.S. stance of not accepting Russia's annexation of Crimea. The sanctions began as a targeted list-based program (as opposed to comprehensive U.S. sanctions programs imposing an embargo on Iran, Sudan and Cuba). Gradually, the U.S. designations have expanded from a small number of individuals to many more and to companies in a number of key industries.

Beginning this past summer, the U.S. government announced the creation of a new type of sanctions measure for deployment in the Ukraine-Related Sanctions Regulations, establishing "sectoral" sanctions designations that target specified segments of the Russian economy. The energy sector is front and center, as are financial services and defense. The nature of the restrictions that apply to SDNs (or sanctioned parties) under the OFAC (Office of Foreign Assets Control) sanctions program is consistent with other U.S. sanctions programs: essentially, U.S. companies and U.S. individuals can't engage in business of any kind with SDNs. The sectoral sanctions designations are more nuanced; they impose only limited and targeted kinds of restrictions for the persons and companies listed.

Four U.S. sanctions directives have been issued to date, imposing different kinds of sectoral sanctions on listed Russian companies, and the EU has implemented parallel measures. U.S. Sanctions Directive 1 targets Russian financial institutions for financing and capital markets restrictions; Directive 2 similarly focuses on the energy sector; and Directive 3 targets the Russian defense sector. These measures impose restrictions on loans, the issuance of debt and the acquisition of newly issued equity of the companies targeted in this way. Later last summer, Directive 4, covering a very small number of Russian energy companies, imposed further restrictions on the provision of goods, services or support by U.S. persons to the companies listed for projects involving exploration or production of Russian energy resources in Arctic, deep-water or shale projects within the territory of the Russian Federation.

Many questions remain as to how U.S. officials are interpreting and applying the sectoral sanctions measures. So far, they have provided clarifying guidance that, for purposes of Directive 4 sanctions: (1) affected deep-water projects entail projects involving E&P activities over 500 feet in depth and (2) shale projects affected by Directive 4 impact exploration or production involving shale from which oil can be extracted, *but not* exploration or production from shale formations through which drilling is made to source reservoirs further down.

The U.S. sanctions also impose export control restrictions on the provision of oil and gas equipment and technology to Russia. I have already mentioned the general ban on provision of goods or services relating to Arctic, deep-water and shale exploration within Russia, but there are broader restrictions as well. High-technology exports are subject to more restrictive licensing policies by the Commerce Department. Further, in addition to the sanctions list maintained by OFAC, the Commerce Department has added a significant number of Russian companies to the Commerce Department's Entities List, which imposes heightened export licensing restrictions on listed companies.

The EU and the U.S. have been coordinating very closely in the development of policy and in the design of sanctions imposed on Russia in connection with events in Ukraine and Crimea this year from the outset. The EU sanctions regime has a different architecture but is similar in scope to the U.S. sanctions program. The EU's sanctions lists also correlate by and large (though not entirely) with the U.S. lists of parties designated as SDNs or SSIs subject to sectoral sanctions. That is no coincidence, but rather a reflection of the negotiations and close coordination between U.S. and European officials in the parallel development of these respective sanctions regimes over weeks and months. We have also seen non-EU-member countries in Europe and elsewhere – including Norway, Switzerland, Canada and Australia – adopt sanctions laws that also track closely with the U.S. and European sanctions programs.

At the same time, other countries, such as China and India, have articulated a policy of opposing international sanctions on Russia. Consequently, Western companies considering participati in business opportunities connected with energy development projects involving China or India, as well as Russia itself, need to be mindful of and conduct appropriate diligence to safeguard sanctions compliance and address potential sanctions risks in the context of such commercial activities.

It should also be noted that international sanctions on Russia, beyond their specific legal impact, have secondary impacts on availability and terms for the provision of lending and finance by international financial institutions. Business risk considerations have escalated for international banks, resulting in increasing limitations on the availability of capital and finance for projects associated with Russia's energy sector and energy sector projects involving Russian companies in other parts of the world.

U.S. sanctions apply not only to parties that are expressly listed as sanctioned parties but also to other entities that are subject to 50 percent or more equity ownership interests of a sanctioned party or group of sanctioned parties. Such ownership interests may be direct or indirect, through layered holdings and corporate structures. The U.S. government aggregates the interests of different sanctioned parties in determining whether the 50 percent threshold is met, thus creating a strong compliance imperative to conduct careful diligence when partnering with companies that are Russian entities, companies in other parts of the world subject to Russian ownership interests or companies that engage in business in Russia or in projects with Russian counterparts in other parts of the world. A general challenge in such compliance efforts is the fact that the typical structure of ownership in many Russian companies is often more complex than for other European or U.S.-based companies. Such corporate structures are typically layered, often with a mixture of entities in several offshore jurisdictions.

Sanctions enforcement has been a rapidly growing priority for the U.S. government in recent years, and the penalties and fines being assessed in enforcement actions have risen exponentially. Consequently, it is crucial for businesses to develop systematic, effective and consistent compliance policies and procedures to address these issues. We generally recommend that companies consider obtaining certifications and notifications, as well as specific terms and conditions written into commercial agreements, to assure compliance with applicable sanctions by contractual counterparties and to establish clear evidence of the diligence and care applied, including such specific compliance measures, to address legal obligations under applicable sanctions measures. Such documented compliance precautions can be critical to providing a clear narrative of your company's compliance practices, in order to be able to respond effectively if your company ever finds itself on the receiving end of an inquiry or investigation by regulators regarding U.S. or European sanctions concerns associated with activities of a business partner of which your company was unaware.

In considering prospects for the future of the current U.S. and international sanctions regime affecting Russia, recent statements by officials in Washington and in Moscow indicate that the current framework of multilateral sanctions on Russia may likely remain in place for quite some time to come. In recent months, the pace of new sanctions measures imposed against Russia has slowed dramatically. We have seen only a handful of additional U.S. or EU sanctions designations occur in the last couple of months, and at nothing like the pace we saw earlier in the year. There have been no additional new sectoral sanctions directives announced since the summer, and the current framework of sanctions will probably be maintained for the foreseeable future, and there are indications that U.S. focus is now turning to enforcement of the established sanctions measures.

Senior U.S. officials have told us that the prospects for this sanctions regime are long-term, and that their frame of reference runs as long as Russia continues to assert its claim of sovereignty over Crimea. At the same time, what we are hearing from Moscow is very much an affirmation of Russia's claim of right in its annexation of Crimea and a stated position that Crimea is part of the Russian heartland and inseparable from Russian national identity. If these divergent narratives continue unchanged, the prospects for U.S. and EU sanctions on Russia can be expected to remain. Accordingly, it appears likely that we will be living with this sanctions program for a long time to come.

Burdick: To add briefly, I happened to be in Moscow recently and visited with various members of senior management of Russian companies. Sanctions won't have an immediate impact on the energy industry, but rather medium- to long-term impact because the sanctions target Arctic, deep-water and shale projects – all areas of opportunity for future development.

A bigger impact will come from the uncertainty over what's next. It's going to be increasingly difficult for Russian companies to find counterparties in Europe or the U.S. That said, the stream of commerce is not completely dry. We were involved in a Russian issuer's debt offering in a European market; pricing was a bit more expensive than is typical for Russian risk, but the market was there. Looking at these things from an energy industry perspective, you're going to see the Russians shifting east. We've already seen this in terms of Gazprom with the deals they've signed with China, and you will see Russian companies becoming more aggressive competitors in other parts of the world where they are able to compete.

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