

# Broad new sanctions targeting Russia

As has been widely reported, the US and the EU have adopted a package of new economic sanctions in response to the ongoing events in Eastern Ukraine, targeting, among other matters, Russia's financial, energy and defence sectors. In this briefing, we set out a summary of the provisions and consider the key issues in the sanctions on both sides of the Atlantic.

## Co-ordinated measures

**The latest sanctions measures adopted by the US and the EU comprise a co-ordinated package of restrictions with wide-ranging implications. The sanctions on both sides of the Atlantic include similar restrictions on financing activities related to certain Russian banks, although there are key differences, which we explore in this briefing.**

As we described in our [briefing last week](#), the US has already imposed targeted sanctions on the Russian financial sector, introducing the "Sectoral Sanctions Identifications" list ("SSI List"), which restricts specified dealings by US persons or involving the US financial system with the entities listed or those owned by them. The EU has now adopted measures which have a similar effect in relation to Russian state-owned banks and the US has expanded the list of entities subject to its restrictions. Similar restrictions have also been imposed in Canada.

**Both the EU and the US have now also imposed further measures in relation to the energy and defence sectors.**

## EU Sanctions

The latest EU measures are set out in Council Regulation (EU) No 825/2014 and Council Regulation (EU) No 833/2014, both of which are directly applicable in all EU Member States. The first of these imposes new trade and investment restrictions in Crimea and Sevastopol, among other matters. The second, which came into force on 1 August 2014, targets certain key sectors of the Russian economy.

These new measures add to existing controls which now include an asset freeze on 95 persons and 23 entities (now

including Russian airline, Dobrolet (a subsidiary of Aeroflot)) and a ban on the import of goods originating in Crimea and Sevastopol into the EU without certificates of Ukrainian origin.

### Financial Sector

Perhaps the most significant restriction is the new prohibition contained in Article 5 of Regulation 833/2014 against directly or indirectly purchasing, selling, providing brokering (defined broadly) or assistance in the issuance of, or otherwise dealing with "transferable securities" and "money-market instruments" with a maturity exceeding 90 days of certain listed state-owned Russian banks or their subsidiaries established outside the EU.

The prohibition applies to transferable securities and money-market instruments with a maturity exceeding 90 days, issued after the date of the Regulation. It does not prohibit dealing in existing bonds or stock issued prior to 1 August 2014. Significantly, while the US measures (referred to below) prohibit trades in "debt", which is interpreted broadly by OFAC, and "equity" (in regard to entities listed under OFAC's Directive 1) the EU prohibitions apply only in relation to transferable securities (defined as those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as shares and bonds) or money-market instruments (defined as those classes of instruments which are normally dealt in on the money market, such as treasury bills, certificates of deposit and commercial papers and excluding instruments of payment).

There is no restriction on lending to the affected banks and existing financing arrangements entered into before 1 August 2014 for these banks are not affected.

The prohibition applies not only in relation to the affected banks, but also their more than 50%-owned subsidiaries and entities acting on their behalf. The Regulation includes

a list of the banks affected: SBERBANK, VTB BANK, GAZPROMBANK, VNESHECONOMBANK (VEB) and ROSSELKHOZBANK

Importantly, EU subsidiaries of the affected banks are exempt from the prohibitions. Branches of the affected banks that are located in the EU but that are incorporated elsewhere (e.g. in Russia) are included within the scope of the Regulation.

The Regulation does not impose an asset freeze on affected banks. It is not prohibited to lend to those banks (other than through bond or stock issuances), or to make/receive payments to or from them.

### Energy Sector

The EU has also imposed new export prohibitions in relation to a list of "key equipment and technology for the oil sector".

A licence is now required from the competent authorities of the relevant Member State for the export to Russia (or for use in Russia) of the listed items. Export licenses will be denied if products are destined for deep water oil exploration and production, arctic oil exploration or production and shale oil projects in Russia. There is a carve out for existing contracts.

This prohibition is similar in form to that which has long existed in relation to Iran and Syria. There is no current prohibition against the provision of related financing or financial assistance. However, financial institutions in the EU will be wary of being involved in deals related to the export of those items without a licence.

### Defence Sector

The EU has also imposed a new embargo against the export of arms and related materiel to Russia, together with controls in relation to the export of all "dual use" goods – technologies that have both civilian and military uses. There are also prohibitions against the provision of related financing, brokering services or technical services.

The prohibition in relation to "dual use" goods applies only where it is suspected that the "end-user" is likely to be the Russian military. Where the end-user is the Russian military, any dual-use goods and technology procured by it shall be deemed to be for military use.

All exporters are required in any event to have a licence for exports of dual-use items to Russia. It will therefore generally fall to the competent authorities of the Member States, when considering licence applications, to determine

whether the end-user might be a military end-user or that the goods might have a military end-use.

There are carve outs in relation to existing contracts, subject to obtaining an authorisation from the competent authority of the relevant Member State.

### Additional restrictions for Crimea and Sevastopol

In addition, pursuant to Regulation 825/2014, there is a ban on new investment (including in the form of loans, credits, acquisitions or creation of joint ventures) in infrastructure projects in the transport, telecommunications and energy sectors in Crimea or Sevastopol or investment in relation to the exploitation of oil, gas and minerals in those regions.

There is also a prohibition against the export of listed key equipment for the same six sectors to Crimea and Sevastopol as well as prohibitions against the provision of related financing, brokering services or insurance services.

## US Sanctions

### Financial and Energy Sector

On 29 July 2014, OFAC expanded the list of entities subject to the existing SSI List controls, by including three state owned banks: OJSC Bank of Moscow, OAO VTB Bank, and OAO Russian Agricultural Bank (also known as Rosselkhozbank). Those banks are also subject to the EU measures referred to above. There are now seven entities on the SSI List, with VEB, Gazprombank, Rosneft and Novatek added on 16 July 2014.

Significantly, and unlike the EU, the SSI List does not include OAO Sberbank, the country's dominant lender.

For the SSI List banks, the listing (under OFAC's SSI Directive 1 aimed at the financial sector) does not impose blocking sanctions on the listed companies but rather prohibits "*transacting in, providing financing for, or otherwise dealing in new debt of longer than 90 days maturity or new equity for these persons, their property, or their interests in property*" after the date of their designation.

The SSI designations of Novatek and Rosneft (two entities not subject to EU prohibitions) give rise to less extensive prohibitions than the other entities. Under OFAC's SSI Directive 2 aimed at the Energy sector, the prohibition is against "*transacting in, providing financing for, or otherwise dealing in new debt of longer than 90 days maturity for these persons, their property, or their interests in property*" after the date of their designation (16 July 2014). The

restrictions in relation to Novatek and Rosneft do not prohibit transacting in new equity releases.

The Sectoral sanctions against both the financial and energy sectors also apply to entities owned 50% or more, directly or indirectly, by the SSI List entities.

In its FAQs OFAC broadly defined debt to include "*bonds, loans, extensions of credit, loan guarantees, letters of credit, drafts, bankers acceptances, discount notes or bills, or commercial paper.*" This is far broader than the EU restrictions.

The SSI sanctions only apply to dealings of US persons or through the US financial system. For this purpose, US persons include (a) US citizens and permanent residents of the United States, wherever located; (b) persons within the United States; and (c) entities organized under US law, including foreign branches. The sanctions also do not apply to pre-existing financial instruments except for new debt rollovers of more than a 90-day duration.

OFAC has further clarified that drawdowns and disbursements pursuant to pre-existing revolving credit facilities or long-term loan arrangements, even if such drawdowns exceed 90 days, are permitted, if the terms of such drawdowns and disbursements, including the length of the repayment period, the interest rate applied, and the maximum drawdown amount were contractually agreed prior to the effective date of the sanctions imposed on the SSI Listed entities and were not modified after that date.

OFAC has issued a general license to clarify that these sanctions generally do not apply to derivative instruments. That continues to be the case. Accordingly, dealings in derivatives with the companies named on the SSI List should generally not be prohibited, nor should dealings in derivatives which reference prohibited new debt or (if applicable) new equity. However, caution should be exercised when dealing in derivatives which could themselves be construed as, or which could be construed as facilitating the issuance of, new debt or (if applicable) new equity.

In its FAQs, OFAC further clarified that US financial institutions may continue to maintain correspondent banking accounts and process USD clearing transactions for the SSI Listed companies, so long as these transactions do not involve the SSI prohibited activities. However, we expect that US banks will apply enhanced due diligence to payments remitted on behalf of these companies and their 50% or more owned subsidiaries to confirm that such payments do not relate to prohibited financial instruments

(e.g., a payment under a "new" letter of credit issued for an SSI Listed importer that enables the importer to defer payment to the issuing bank for more than 90 days).

The SSI designations do not prohibit US persons from providing financial, legal or other professional services to the affected companies unless such services related to prohibited financial instruments, which would include the extension of a pre-existing credit period for an additional term of greater than 90 days.

### SDN Designations

OFAC has listed a number of entities in Russia and Ukraine on its list of Specially Designated Nationals and Blocked Persons (SDN list) under its Ukraine-related sanctions program. These designations impose a blocking requirement on US persons and prohibit the involvement of US persons or the US financial system in dealings with the SDNs or entities owned 50% or more, directly or indirectly, by the SDNs. Most recently, on 29 July 2014, OFAC added a Russian defense technology company, OJSC United Shipbuilding Corporation, to the SDN list.

### Export Restrictions

The US Department of Commerce's Bureau of Industry and Security (BIS), which administers the Export Administration Regulations (EAR) controlling the transfer of US jurisdiction "dual use" goods, also imposed further restrictions on trade with Russia on 29 July 2014. BIS announced that it has adopted a policy of denying US export licenses for the "*export, reexport or transfer of certain items for use in Russia's energy sector that may be used for exploration or production from deepwater, Arctic offshore, or shale projects that have the potential to produce oil.*" BIS had previously announced that it was restricting the issue of new export licenses for exports and re-exports to Russia, and that it also had placed a hold on issuing licenses for the transfer of high technology products to Russia or Crimea that would contribute to Russia's military capabilities.

In addition, BIS has added a number of Russian and Ukrainian entities to the Entity List, such as the 29 July 2014 addition of OJSC United Shipbuilding Corporation. Designation on the Entity List means that a BIS license is required for the transfer of items subject to the EAR to the listed company, with BIS operating under a presumption of denial of the license.

The US State Department's Directorate of Defense Trade Controls (DDTC) that controls the export of defense articles

and services had also previously announced it would deny pending license applications for high technology exports or re-exports to Russia.

### Canada and Japan Sanctions

On 24 July 2014, Canada announced new sanctions in connection with the situation in Ukraine, which include similar measures to those imposed in the EU and the US. Japan Sanctions

On 28 July 2014, Japan announced that it will impose additional sanctions against Russia include asset freezes and a restriction on imports from Crimea in line with existing EU measures.

It is anticipated that both Canada and Japan may extend their restrictions in line with the EU and US measures.

### Russian Counter-Measures

The extent of counter-measures that may be imposed by the Russian Federation is unknown. On 30 July, the Russian Central Bank issued a statement that "*if necessary, adequate measures will be taken to support the affected Russian Banks*" with the view of protecting interests of their customers, depositors and creditors. It is not yet clear what form those measures may take.

### Future Developments

This latest package of sanctions is by no means the last word on the current situation. As the situation in Ukraine evolves, the prospect of further sanctions in the coming days and weeks looms large.

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