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SANCTIONS – A GLOBAL PERSPECTIVE



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Over the last decade, US authorities have enlisted others in the international community in the effort to curb nuclear proliferation, terrorism, and political oppression through economic sanctions. Now regulators and enforcement agencies outside the United States are increasingly cooperating in their focus on compliance with sanctions laws and regulations as part of a worldwide crackdown. The risk of prosecution or other official censure is rising and there are practical, commercial and civil risks for businesses that find their transactions are affected by new or emerging sanctions. New sanctions can be imposed at any time in response to changing political events: what may be permitted today, may not be allowed tomorrow. It is a constant challenge for international businesses to keep on top of those changes. The risk of significant fines, and imprisonment, is rising for those who fail to appreciate and address this challenge. Here Clifford Chance experts from across the globe give an overview on sanctions and the risks that organisations face.

The US perspective

Partner Wendy Wysong, who works in both Washington DC and Hong Kong, says that sanctions have changed dramatically. “Twenty years ago when I first started working in economic sanctions as a prosecutor it was pretty simple. The US Office of Foreign Assets Control (OFAC) had a set of rules and if an organisation broke those rules, it was fined US\$11,000 per violation. If the government could prove that you deliberately broke those rules you might be subject to criminal sanctions. Now the landscape is quite different. Fines are \$250,000 per violation, twice the value of the transactions, or, in the case of criminal violations as much as \$1 million per violation and individuals can go to jail for as long as 20 years for violating sanctions and export controls.”

Financial institutions have borne the brunt of these fines – usually over issues of transparency. As well as OFAC, the Department of Justice, New York State Prosecutors, the New York District Attorney’s Office, the bank regulators, the Federal Reserve and the New York Department of Financial Services have all become involved in sanctions issues. “Instead of a knock on the door by the OFAC, now we’re seeing full-scale search



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warrants, subpoenas, arrests and all the mechanisms that would be in play in any type of criminal action,” says Wysong.

As a result, banks have been turning over all their information to the regulators and now it’s a question of which cases they go after rather than which few are they going to be able to find. Corporates are increasingly being pursued for sanctions violations as well. DHL, for example, had to pay US\$9.4 million in fines to resolve allegations that it aided illegal shipments to Iran, Sudan and Syria; and Fokker Technologies of the Netherlands, agreed to pay US\$21 million in penalties to settle allegations that it sold aircraft parts to Iran and Sudan. Two international oil and gas field service companies, Swiss-based company Weatherford and French-based company Schlumberger, paid criminal and civil fines totalling \$98 million and \$233 million respectively in the last two years.

Where will US regulators look next? Wysong says: “If Western banks are no longer providing financing and facilitation for transactions that offend OFAC sanctions, and are turning over records that reveal who continues to do so, OFAC will look to cut off those sources of funds. It is uncertain whether OFAC will be able to extend its sanctions enforcement to such entities, perhaps a state owned Chinese bank, for example. But when I talk to Chinese banks, they’re ready to listen. A couple of years ago they would just nod politely and give me a cup of tea, now they are actually taking notes and asking questions.” She adds that every industry sector, but particularly defence, aerospace and telecoms and others involved in large international projects, face sanctions risks.

The UK and EU perspective

The UK government has seen that there are lessons to be learned from the way in which OFAC provides a certain amount of clarity and

guidance on sanctions. The Treasury has announced that it is going to set up a new Office of Financial Sanctions Implementation to raise awareness and provide support to assist compliance and understanding around the sanctions regulations. Its remit will also be to ensure enforcement action against those that flout sanctions, and the government has indicated that higher penalties will be sought. The unit is due to become operational early in 2016.

London-based Partner Rae Lindsay, says: “The Office of Financial Sanctions Implementation only goes a certain amount of the way in providing resource to help firms better understand their compliance requirements. There is still a need for a central European authority whose role is to provide meaningful guidance on sanctions across member states, to ensure a level playing field. The European Commission guidance that was provided in relation to Russia was a welcome move in the right direction.”

Lindsay adds that, in contrast to the US, there is a perceptible increase in sanctions related litigation in Europe. Some focuses on interpretation of sanctions measures, including their impact on contracts. We are likely, she predicts, to see more of that in the future. There have also been more fundamental challenges to the legislation: for example, Russian state-controlled oil group Rosneft, has challenged the



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Wendy Wysong, Partner, Washington DC and Hong Kong

validity of recent EU sanctions and associated orders in the UK giving effect to them.

Sanctions and Iran

In July, after 18 months of negotiations, the five UN permanent countries (US, Russia, France, China and the UK) plus Germany and the EU agreed a deal with Iran – the Joint Comprehensive Plan of Action (JCPOA) – which puts limits on Iran’s nuclear programme and will see economic sanctions against it lifted sometime in 2016, enabling it to revitalise its energy and financial markets.

Partner George Kleinfeld, who is based in Washington DC, says: “From a European perspective you will hear that sanctions relief is quite extensive. But from a US perspective that’s simply not the case and the misconceptions around this issue have already led some clients to make some pretty big mistakes both in terms of jumping the gun against the timing of sanctions relief and wholesale misinterpretation of the scope.”

The lifting of sanctions, “implementation day” will occur when Iran demonstrates to the satisfaction of the International Atomic Energy Agency that it has met its non-proliferation obligations. That may happen early in 2016, but it may not happen until later in the year. “Until then, there’s no change whatsoever in the current sanctions. As of implementation day, the sanctions other than the US sanctions will be largely removed, but the US sanctions will not,” says Kleinfeld.

US sanctions will still apply to non-US persons to the extent that they involve US offices, US employees, US counterparties, the US financial system or goods from the US. Iran didn’t bargain for the removal of those US jurisdiction-based sanctions and the US has no obligation to remove them. “Politically, it’s simply a non-starter in the

US to remove those sanctions so they’re not going to be removed. There’ll be some very minor licensing for certain types of activity. Most importantly, non-US subsidiaries of US companies will be able to do Iranian business, subject to the non-involvement of their US parents,” says Kleinfeld.

What does this mean post-implementation day for European enterprises and European financial institutions? “A compliance nightmare of almost biblical proportions,” says Kleinfeld, “because the US financial system, US origin goods and US persons are very difficult to wall off from European economic activity with Iran or with any other third country.”

European governments are likely to pressurise European financial institutions to support European business with Iran so that Iran keeps to its side of the deal on its nuclear programme. “The US is not going to be flag waving and cheering for more European business with Iran but the secondary sanctions that they’ve used to deter the non-US business with Iran will largely be gone,” says Kleinfeld.

However, while there is likely to be a great deal of interest in doing business with Iran on the part of non-US companies, prominent European financial institutions are likely to be extremely reluctant to support that business



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George Kleinfeld, Partner, Washington DC

because it will be very difficult for them to insulate their global business from US jurisdictional elements. In addition, US enforcement agencies will be poised and ready to swoop on any perceived infringement. Kleinfeld says: “Whatever profit European companies expect to make on future opportunities with Iran, I think they had better reinvest a big chunk of it in compliance controls because they face serious enforcement risks.”

He also adds that the US and the EU can use a “snapback mechanism” and re-impose current sanctions if Iran violates its obligations regarding its nuclear programme and it is a route that a future Republican administration could take. “In which case everyone is going to be running for the exit at the same time and commercially that will need to be addressed,” Kleinfeld says.

Russia and sanctions

Counsel Adam Fadian, a finance lawyer based in Moscow, says that there is now a sense of relative stability with respect to sanctions in Russia.

“The main uncertainty we faced in 2014 wasn’t so much around how to interpret the sanctions or how to apply them, but the fact that we didn’t know what was coming next.” 2014 was a constantly changing landscape in which sanctions were being announced and updated on a regular basis. At first these sanctions targeted relatively obscure companies and individuals, but that all changed in the summer of 2014 when the US unveiled a new type of sanctions – so called ‘sectoral’ sanctions – which targeted some of Russia’s largest companies and banks. “That was a real game changer - there was then a sense that no-one was off limits and that new sanctions could be announced at any time,” says Fadian.

The situation has since stabilised. This year there has been some rather limited updates and

additions to the US and EU sanctions, but nothing like the level of activity that we saw last year. “There is now a sense of stability and, for the most part, people are starting to come to grips with the sanctions and adapting to the new reality of doing business in Russia,” says Fadian.

Recently there has been increased activity by Russian companies in the international debt markets. In the first significant eurobond issuances by Russian companies in almost a year, the country’s largest mining and energy companies, Norilsk Nickel and Gazprom, recently raised over \$2 billion through the issuance of eurobonds. A number of Russian companies have also been tapping the international loans markets throughout 2015.

In terms of documentation, sanctions provisions continue to be a heavily negotiated issue on loan transactions. Fadian says that almost all Russian loan transactions feature sanctions-specific wording in documentation, because banks are generally not comfortable relying on generic provisions in standard LMA documentation. “Russian borrowers are now more accepting of sanctions provisions in their documentation. Certainly they don’t like them - they’ll negotiate them extensively, but they do understand that such provisions are part of the new reality of international banks lending into Russia,” he says.

There is still no market standard with respect to sanctions provisions in the Russian loan market. However, many of the banks that are



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Adam Fadian, Counsel, Moscow

active in the region have recently developed or updated their sanctions policies and seek to implement their policy wording on each deal. “In our experience, although the policy wording for each bank tends to differ, the substance is in fact very similar, and it will be interesting to see whether the continued use of such policies, particularly on club deals, will be a catalyst for developing a market standard for sanctions provisions in Russia,” says Fadian.

From a US perspective, Partner George Kleinfeld says that the US and the EU are committed to working together on Russian sanctions and that if nothing changes in the Eastern Ukraine those sanctions aren’t going to change. He adds that US Russian sanctions are not as overtly and aggressively extraterritorial as those against Iran “but the US State Department and OFAC are perfectly prepared to caution major non-US players that if they embark on significant new deals in the more sensitive sectors of the Russian economy, even if those deals are carefully structured not to involve any US elements, there is a designation risk: This is because of the executive orders that give the US the ability to designate virtually anyone engaged in Russia’s energy sector, Russia’s metal sector, defence or financial sectors as subject to sanctions.”

The perspective from Germany

Germany takes a very different enforcement approach compared with the US. The German prosecution and enforcement authorities have prosecuted, and continue to prosecute, straightforward, bold, intentional violations, especially those involving camouflaging techniques with intermediaries and agents. “At a recent sanctions conference, a speaker from the German Federal Criminal Prosecutor has made it quite clear that they will not go after and prosecute deficiency in compliance systems and will not try to make companies and banks into

deputies enforcing export control and embargo laws in Germany,” says Frankfurt-based Partner, Heiner Hugger.

He adds that with regard to Iran, German companies across all sectors are interested in getting back into the Iranian market. “This is heavily supported and encouraged by politicians and business associations and it will be very important, particularly for German banks, that exposure to continuing US restrictions is manageable.”

What does the future hold?

Given current geopolitical turmoil, the international community will continue to look to sanctions as a policy tool: one that often places the private sector on the front line. Compliance will continue to be a challenge and enforcement is likely to feature higher on the domestic agenda of states beyond the US. An increasing focus on sanctions compliance in transactional due diligence and documentation will further increase awareness and attention; and in turn the potential for interpretational disagreement and litigation in some quarters.

Importantly, markets will watch closely the impacts of the easing of Iranian sanctions on corporate activity and investment. It will be interesting to see whether the recent policy alignment of the US and Europe on sanctions more generally is shaken by the disparities in sanctions regulation that are envisaged by the JCPOA, and which threaten to bring the associated and potentially conflicting compliance challenges back to the fore.



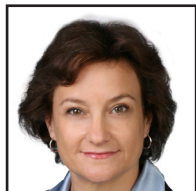
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Heiner Hugger, Partner, Frankfurt

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