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LATEST TRENDS IN ECONOMIC SANCTIONS AND TRADE CONTROLS

— THOUGHT LEADERSHIP

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In this extract from a recent Clifford Chance webinar, we explore the latest trends in US, EU and UK policy on economic sanctions and trade controls, including compliance and enforcement risks and potential changes under the Biden Administration. We examine efforts to roll-back Trump era US secondary sanctions on Iran; current US trade controls on China; US, EU and UK sanctions on Russia; Europe's new human rights sanctions and the impact of the existing US Magnitsky sanctions; and post-Brexit UK sanctions.

Iran sanctions – what's happened so far?

- The US and Europe entered in to the Joint Comprehensive Plan of Action (JCPOA) with Iran in 2015 under which the US rolled back many, but not all, economic sanctions against Iran in exchange for temporary curbs on the Iranian nuclear ambitions. The JCPOA went into effect in January 2016.
- In 2018, President Trump withdrew the US from the deal, a step he could unilaterally take because the deal wasn't ratified by the US Congress which reimposed significant US unilateral sanctions against Iran.
- In July 2019 Iran announced that if the US wasn't going to comply, then it wouldn't comply either.
- President Biden reached out to try to re-negotiate the re-entry of the US back into the deal but said he wouldn't remove the US sanctions until Iran came back into compliance. Iran said no, we're not going to negotiate until you remove the sanctions.

Iran and sanctions

The Joint Comprehensive Plan of Action JCPOA entered into by the US and Europe with Iran, implemented in January 2016 was regarded as a diplomatic accomplishment by the Obama Administration and many of those involved in its formulation are now senior figures within the Biden Administration. However, the current Administration has inherited a raft of primary and secondary sanctions introduced by President Trump and the question is what happens next? George Kleinfeld, a Washington DC-based, Clifford Chance partner and member of the Firm's global sanctions and export control team says: "There are very strong political headwinds in the US against anything that could be characterised as an economic windfall for Iran, when there are no economic benefits to the US from lifting secondary sanctions, which impose costs entirely on non-US business interests. There is no scenario, at least in the short term, of the US putting a removal of US primary sanctions on the table."

He adds that the Biden team is very keen to bring Iran into a new set of enforceable commitments and is prepared to turn the clock back and restore JCPOA in return for a permanent non-nuclear enforcement commitment from Iran. "Will they get there? I'm pretty sure it won't happen in a hurry, but it's in everyone's interests to go through a period of confidence building through phased concessions," says Kleinfeld.

The European position on Iran

The EU's High Representative of Foreign Affairs described recent developments in Iran as worrying but said he remained optimistic of a full return to the JCPOA. If that can't be achieved, then there has to be a realistic prospect that EU sanctions (so far largely limited) could be re-imposed.

If the deal is resurrected and the extra-territorial US sanctions imposed under President Trump are rolled back, it could pave the way for some European businesses to re-engage with Iran. However, the prospects of that happening in practical terms are limited. Many European businesses did not re-engage with Iran when the JCPOA was first implemented in 2016 because of the risk of US primary sanctions, and that is not likely to change now.

"The US sanctions won't be lifted altogether, even in the best case scenario, and many are likely to be wary. We have been here before – one of Iran's biggest complaints under the deal when it first was launched in 2016 is that the promised trade with Europe didn't materialise – in a dollar-dominated world economy that is unlikely to change," says Michael Lyons – a London-based Partner who specialises in financial crime compliance issues and economic sanctions.

There could however be two consequences of note on the European side: The first is that the lifting of US sanctions could effectively nullify in practical terms the effect of the EU's so-called Blocking Regulation, which Lyons says has caused a "compliance headache" since amended in 2018. The amended Blocking Regulation was part of a package of measures adopted in the summer of 2018 when President Trump withdrew from the deal and reimposed extraterritorial secondary sanctions. The Blocking Regulation was designed to protect European businesses from the effect of those sanctions. But amongst other matters, it prohibits compliance by European operators with those sanctions. "It has largely been ineffective – really the only thing it has done is cause a legal conflict for those European businesses that want to comply with US sanctions or at least who wish to manage their risk." he says.

The second consequence is the potential invigoration of the mechanism called INSTEX, which is a barter system designed to help trade flow with Iran bypassing the financial system (given the reluctance of most European banks to be involved). Lyons says that Instex has not really got off the ground so far, partly because of operational issues and partly because even in the current climate the value of European exports to Iran exceeds the value of Iranian exports to Europe. The main issue though has been concern that by using it, companies will risk falling foul of US sanctions.

However, "If the deal is brought back to life, then it might have a greater chance of success if those threats fall away," he says.

China and the US

President Trump rolled out a wide range of restrictive measures against China during his term of office. Sanctions ranged from targeting individuals, using the Global Magnitsky Act, to Executive Orders such as EO 13971, which attempted to ban transactions with certain Chinese apps. On the export control side, the Trump Administration revamped and expanded the military end use rule, restricting exports of certain items intended for military end use to China, Russia and Venezuela. Perhaps of most interest to financial institutions was the creation of the Communist Chinese Military Companies list (CCMC) which essentially prohibits US persons from engaging in transactions for the purchase of publicly traded securities with any of these CCMC entities. There is a grace period by which US persons may divest these securities, but after that period ends, US persons are essentially prohibited from holding any of these securities.

Renee Latour, a Washington DC-based Clifford Chance Partner specialising in international trade regulation, says that the CCMC prohibitions raises unique compliance-related questions for non-US financial institutions. A common challenge is determining what level of due diligence is most appropriate to protect against engaging in or facilitating sanctioned or prohibited trade. "The intricate web of interconnecting restrictions and sanctions that are the legacy of the Trump administration is tricky for non-US entities, including foreign financial institutions, to navigate. For the moment it's a case of 'watch this space'."

China's reaction

In response to the challenges caused by US sanctions, China introduced a new blocking statute in early January. This should be familiar to the EU market, as it is largely modelled on the EU blocking statute. Although the blocking statute doesn't clearly state so, a reasonable interpretation is that it only binds Chinese parties. European companies' subsidiaries incorporated in China are clearly bound by the blocking statute. Their branches in China might also be captured, but this is not clear. "We think it is better to err on the side of caution and assume that they are also going to be bound by the blocking statute," says Lei Shi, a Clifford Chance Partner based in Shanghai, specialising in China-related dispute resolution, international arbitration and regulatory compliance. China's blocking statute has not yet designated any foreign law as "blocked." Instead, it sets up a framework under which the

Chinese Ministry of Commerce would review and issue prohibition orders against particular foreign laws. "It looks like US secondary sanctions are the primary target of this new law, but the law has been drafted very broadly to be able to capture other types of restrictive measures," he says.

What are the consequences of violating the blocking statute? If MOFCOM – China's commerce ministry – issues a prohibition order against any foreign law, Chinese parties would be required not to comply with the foreign law, unless they receive an exemption from MOFCOM. If they violate the prohibition order, there would be two potential consequences: civil litigation and administrative penalties.

The blocking statute also imposes a reporting obligation on Chinese Parties for foreign law and measures potentially falling within its scope. Most multinational companies are adopting a wait-and-see approach to the blocking statute and its likely impact, Shi says. "Once any foreign law is designated under a prohibition order, then the Chinese subsidiaries of European companies might face the dilemma of complying with the blocked foreign law or the Chinese prohibition order. Therefore, it is advisable to structure deals to minimise the risks of facing this dilemma," he says. European companies could also expect to see more push-back from Chinese counterparties in agreeing on sanctions compliance provisions in their contracts.

"The lack of clarity on how these measures are going to be enforced and the details of the regulations, puts a premium on risk management for banks that are operating in that market and it goes without saying, that the Chinese reaction may be different if things continue to escalate," says Washington DC-based Partner, David DiBari, who is co-head of the Global Risk Team.

What changes can we expect from the Biden Administration?

China-related measures were implemented with bi-partisan support in the US, so it would be surprising for the Biden Administration to make substantial changes to export controls or sanctions already implemented. "That being said, the Administration's request to pause legal proceedings surrounding the Trump-intended ban of WeChat and TikTok while it reviews the underlying Trump restrictions indicates a commitment to review previous measures," explains Renee Latour.

She adds that it's a policy very much in flux but the markers are there. The Biden Administration has indicated an intent to approach China with fresh eyes. As a result, it is likely that some aspects of the Trump administration may survive, but not all and certainly not without scrutiny. At her confirmation hearings, US Trade Representative, Katherine Tai, pledged that the Biden Administration would undertake an "holistic review on the US-China strategy." Further, President Biden signed an executive order mandating a 100-day review of US supply chains in four areas, notably including semiconductors.

In addition, President Biden is also calling for a separate, one-year review of supply chains covering six broader sectors, from technology to food production. "The key takeaway is that wholesale restrictions are not expected to increase immediately. Most likely would be specific sanctions or restrictions against specific entities. Even more likely is that a precise removal of Trump-era measures may take place. Essentially, the scalpel approach as opposed to the cleaver approach," she says.

What is the future for US sanctions policy towards Russia?

George Kleinfeld, says: "I do not see any clear exit from the current impasse and tit for tat upticks in US sanctions in response to Russian provocations. The Biden Administration has no apparent ability to obtain any leverage through additional sanctions over Russian conduct, but also no present incentive or pretext to unwind any sanctions."

He adds that the raft of US sanctions against Russia have not achieved their intended objective of deterring it from aggression in the Ukraine and other parts

of the former Soviet Union, cyber attacks and political repression within the country.

US sanctions under Presidents Obama and Trump attempted to avoid an all-out trade embargo against Russia recognising that would impose huge collateral costs and be potentially highly destabilising, but the then-newly designed sectoral and other Russian sanctions intended to put incremental pressure on the Kremlin have not worked. "I just think we are locked into this cycle of incremental additional sanctions that do not really achieve anything helpful and put new burdens on the financial sector in respect of compliance," he says. In future, we are likely to see additional incremental US sanctions in response to political repression namely the imprisonment of opposition leader Alexei Navalny, incremental additional sanctions designations in respect of the most recent Russia cyber espionage in the US and continued efforts to deter the completion of the Nord Stream 2 Pipeline and the extension of the Turk Stream Pipeline into the Balkans.

"The big change with the Biden Administration is that it is deeply committed to collaboration and cooperation with European allies and certainly has a much healthier recognition that European energy security is something that should be primarily addressed by Europeans rather than through US secondary sanctions policy. We may see some designations of additional Russian and non-European parties to the attempted completion of the Nord Stream 2 Pipeline, but I seriously doubt you'll see designations of any prominent European financial institutions or European corporates or European state instrumentalities. I think instead the emphasis will be on negotiation and perhaps threats but in the form of threats intended primarily as a spur to negotiations."

Europe's position on Russia

Since the implementation of targeted sanctions against Russia in 2014, there have been no significant changes to the general Russia-specific sanctions regimes of the EU, apart from some changes and additions to the relevant lists of sanctioned persons.

The relationship between the EU and Russia is strained, not least because of the imprisonment of Alexei Navalny. However, fundamental changes to the sanctions regimes are not expected for the near future. Instead, the EU is likely to continue making use of non-geographical sanctions regimes not specifically targeting Russia as was done in the recent past where it was made use of the thematical sanctions regimes concerning cyber-attacks and use of chemical weapons. In response to Navalny's conviction, the EU now designated four persons under the new EU Human Rights Sanctions Regime, which was adopted in December 2020. This is modeled on the US Global Magnitsky Act. Until its adoption, in cases of serious human rights violations, the EU could only use existing or new country-based sanctions, but this involved a high geopolitical cost due to the damaging effect on bilateral relations. The new regime enables the EU to target individuals, entities and bodies involved in serious human rights violations worldwide. Relevant violations include genocide, torture and arbitrary detentions.

The regime is unlikely to have a huge impact on the general business of EU financial institutions as it aims to targeted selected persons not business sectors. For instance, in the case of Navalny, the EU has sanctioned Russia's prosecutor general and the heads of its prisons service, national guard and investigative committee.

"The focus on these thematical sanctions is political and strategic," says Frankfurt based Clifford Chance Counsel, Gerson Raiser, who specialises in economic and trade sanctions and anti-money laundering. "The strong economic links and the energy supply needs of EU member states, means there is some reluctance to restrict business with Russia more broadly."

He adds that with regards to energy, the EU is caught between Russia and the US. Natural gas pipeline projects such as Nord Stream 2 (from Russia to Germany) are heavily targeted by US extraterritorial sanctions. As a result, increasing

numbers of EU entities and insurers withdrew from the project and since the conviction of Navalny, the French government and the European Parliament have requested that the project be stopped.

"There are clear indications that the US is willing to take a coordinated approach with the EU. However, if the Biden Administration should decide to further target the Russian energy sector, the question of blocking or countering extraterritorial US sanctions by the EU may play a more important role in the future," Raiser says.

The EU is considering strengthening its tools to block extraterritorial sanctions. In January 2021, the European Commission issued an official communication on the strategy for its economic and financial system, one of the main pillars of which is to ensure resilience to extraterritorial sanctions. However, the Communication, so far, is vague. Raiser says: "It remains to be seen whether the EU comes up with concrete solutions. Nevertheless, it appears that the EU clearly sees the need to act in that context to try to better shield EU financial institutions in the future."

What about the UK – post-Brexit?

UK sanctions are now set out in a series of Statutory Instruments which are made under the Sanctions and Money Laundering Act of 2018. They broadly replicate the existing EU sanctions in place as at 31 December 2020, which was when the transition period came to an end. "But while those regulations are intended to deliver substantially the same policy effects as the existing EU regimes, the Office for Financial Sanction Implementation (OFSI)) has itself said you should not assume that they are identical," says Lyons. There are, in fact, many distinctions between the EU and UK regimes. The vast majority are likely to be inconsequential in practice. But there are at least five important points to consider.

1. Jurisdiction – the new UK sanctions regulations apply to UK persons anywhere and to UK incorporated companies anywhere – so no change there. They also apply to any conduct within the UK. There is no history of enforcement against a non-UK person on the basis of (for example) a transaction which is cleared by a UK bank, but in guidance issued in 2017 and updated recently, OFSI – the UK body responsible, expressly notes that this may be sufficient to create a UK nexus.
2. The UK sanctions regulations provide expressly that funds or economic resources are to be "treated as owned, held or controlled by a designated person if they are owned, held or controlled by a person who is owned or controlled directly or indirectly … by the designated person". This enshrines as an automatic requirement what was, under the EU regime, a rebuttable presumption. This may require extended KYC /due diligence in appropriate cases to ensure that counterparties are not indirectly controlled by a designated person. Particular care is likely to be needed when dealing with group companies where directors or one or more shareholders are designated persons.
3. Where trade controls apply on restrictions of exports to certain countries, there are now restrictions on the export of those items to persons "connected to those countries," which includes companies incorporated in those countries even if located overseas. So, for example, the restriction on exports of energy-related items to Russia without a licence now applies equally to exports of those items to Russian companies even outside Russia without a licence. There is a general licence which means an individual application is not needed when seeking to do such business, but there are detailed record keeping and related requirements to comply with in those cases.

4. There are also some jurisdictional changes, notably also on the Sectoral Sanctions against Russia – for example, EU Sectoral Sanctions prohibit new loans or credits to targeted entities except where the loan or credit has a documented and specific purpose of financing trade with the EU. As it is now no longer part of the EU, trade between (for example) the UK and Russia will no longer qualify. Similarly, under the UK sanctions, loans which finance trade between the EU and Russia will not be exempt from the UK prohibition. Also, where EU sanctions on Russia provide exceptions for EU-based subsidiaries of targeted entities, the UK regimes provide only exceptions for UK-based subsidiaries.

5. The lists of targets are no longer the same – the UK has been faster to move on imposing sanctions on Burma and Russia in recent weeks than the EU. And the lists are not identical. So companies operating internationally will need to ensure all relevant lists are checked against.

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