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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 the status of the Joint Comprehensive Plan of Action with Iran; current US trade controls on China and China's response; US, EU and UK sanctions on Russia; Europe's new human rights 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. The recent election of new Iranian president Ebrahim Raisi has seemingly caused a temporary pause in the negotiations progress, as Raisi favors a much tougher stance with respect to the United States.
- Time is of the essence in terms of reinstating the JCPOA, with key deadlines approaching as soon as 2023 and October 2025 set as the date – under the original agreement – for the lifting of all nuclear-related.

Iran and sanctions

The Joint Comprehensive Plan of Action JCPOA entered into by the US and Europe with Iran, implemented in January 2016, was negotiated for the US under the Obama Administration and many of those involved in its formulation are now senior figures within the Biden Administration.

However, the Trump Administration withdrew the US from the JCPOA, and implemented a policy of "maximum pressure" on Iran. The question is whether the Biden Administration will succeed in its efforts to renegotiate the JCPOA in the face of the recently new hard-line Iranian presidential administration. Renee Latour, a Clifford Chance partner based in Washington, D.C. specializing in international trade, with a focus on global sanctions and export controls, says: "When President Biden took office, the administration signaled a strong willingness to return to the JCPOA – from which the United States withdrew under President Trump. Since then, negotiations have been continually taking place amongst the JCPOA member countries."

She adds that the members of the JCPOA have reportedly made significant progress in their negotiations, but that the recent election of reputed hard-liner Ebrahim Raisi to the Iranian presidency has complicated matters, as the negotiators wait to see how the new Iranian President will approach the negotiations. The negotiators also face new and increased time pressures, as key deadlines approach in 2023. Latour notes that while "what has been called 'a substantial amount' of progress has been made, the fact remains that no agreement has been reached as of yet."

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 reimposed.

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 materialize – in a dollar-dominated world economy that is unlikely to change," says Michael Lyons – a London-based Partner who specializes 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 being 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 to put EU entities between a rock and a hard place: a rock – threatening penalties under US sanctions; a hard place – threatening civil claims and fines under the Blocking Regulation if they violate it" says Frankfurt based Clifford Chance Counsel, Gerson Raiser, who specializes in economic and trade sanctions and anti-money laundering.

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."

The second consequence of a resurrection of the deal with Iran is the potential invigoration of the mechanism called INSTEX, which is a barter system designed to help trade flow with Iran by 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. The Trump Administration introduced new sanctions, particularly focused on Hong Kong but also on entities from the Xinjiang region, restrictions on U.S. investment into certain Chinese military entities, and required divestment of subject securities, and heightened scrutiny of Chinese investment into the United States via the CFIUS process.

On the export control side, the Trump Administration revamped and expanded the military end use rule, preventing exports of certain items intended for military end use to China, Russia and Venezuela. President Trump's actions against China included prioritising US persons from engaging in transactions for the purchase of publicly traded securities with any of the Communist Chinese Military Companies (CCMC) entities. Renee Latour notes, "interestingly, in June of 2021, President Biden revamped and expanded these restrictions, creating a new securities-related sanctions regime for so-called 'Chinese Military-Industrial Complex Companies' that is effectively separate from the CCMC list maintained by the US Department of Defense." The new measure expands the criteria for designation beyond Chinese military companies to include companies in the surveillance technology sector of China’s economy, and adds new entities to the subject restrictions.

The United States has also imposed import restrictions in response to perceived activity in Xinjiang. Although not a traditional "sanctions" measure, the U.S. Customs and Border Protection has begun actively issuing Withhold Release

Orders ("WROs") on certain products and entities originating in the Xinjiang region, that effectively serve as seizure notices for such goods upon import into the United States.

Renee Latour says that these new restrictive measures raise 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, and simply keeping abreast of the legacy Trump and continually introduced Biden measures with respect to China. As Latour says, "it's a lot" for companies to monitor and navigate from a compliance perspective.

China's reaction

In response to the challenges caused by US sanctions, China introduced a new blocking statute in early January and new Anti-Foreign Sanctions Law in June.

With respect to the blocking statute, although it doesn't clearly state so, a reasonable interpretation is that it only binds Chinese parties. Multinational 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 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, specializing 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.

Regarding the Anti-Foreign Sanctions Law (AFSL), it is primarily an effort to set out a legal framework for ad hoc sanctions already imposed by the PRC government on foreign individuals and entities. Different from the blocking statute, the AFSL is expected to primarily focus on countering foreign sanctions imposed on Chinese parties for the purpose of "interfering with China's internal affairs." The AFSL authorizes the PRC government agencies to designate foreign parties and their affiliates to the Chinese sanctions list, which may result in denial of visa, freezing of assets and prohibition of parties in the PRC from dealing with those on the sanctions list. The AFSL also imposes a general obligation on any parties not to "implement or assist in the implementation of discriminatory restrictive measures taken by any foreign country against any Chinese citizens or organizations", whilst its exact implication is subject to further clarifications from the PRC government.

"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, D.C. -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 a "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?

Renee Latour, says: "Russia is an interesting topic, and I think actually serves to highlight the US commitment to reinstating its ties with Europe. From a formal perspective, it appeared that the Biden Administration was going to strike a markedly different tone than the Trump Administration. It was expected that President Biden would adopt a much more adversarial stance." Sanctions were imposed very early on in the President Biden's presidency in response to the alleged poisoning of opposition leader Aleksei Navalny by a chemical agent. The United States formally codified its denial policy on exports of defense articles to Russia, and implemented additional export restrictions against the Russian military and for commercial items destined for military end uses.

Following those actions, however, the Biden Administration focused again on its pledged commitment to collaboration and cooperation with European allies, indicating that further significant sanctions are not likely to be issued in the near future. In May 2021, the Biden Administration waived sanctions on Nord Stream 2 AG, the German entity in charge of the Nord Stream 2 pipeline project, and its CEO, despite confirming in a report to the US Congress that the two are engaged in "sanctionable activities." This decision ultimately underscores President Biden's commitment to multilateralism and restoring and strengthening ties with European allies, as opposed to pursuing aggressive sanctions measures towards Russia.

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 in the recent past where it made use of the thematical sanctions regimes concerning cyber-attacks and use of chemical weapons. In response to Navalny's conviction, the EU designated 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 detention.

The regime is unlikely to have a huge impact on the general business of EU entities as it aims to target selected persons not business sectors. However, it was already shown that it nevertheless can have significant impacts. In March 2021, the EU used the new sanctions regime to impose sanctions against Chinese persons – the first human rights-related EU sanctions against China since 1989. This decision, and China's responses, led to a significant shift in relations between the EU and China. In particular, the European Parliament paused the ratification of the EU-China Comprehensive Agreement on Investment – a significant trade agreement which had principally been agreed in December 2020 after years of negotiations.

"As regards Russia, the focus on these thematical sanctions is political and strategic," says Gerson Raiser. "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, which was shown for instance by the developments with respect to the natural gas pipeline Nord Stream 2 (from Russia to Germany). The project was heavily targeted by US extraterritorial sanctions. As a result, several EU entities and insurers withdrew from the project. However, ultimately the Biden administration has been clearly willing to take a coordinated approach with the EU. In May, the US decided to refrain from further sanctions against the project. Furthermore, the US and Germany – one of the project's largest supporters – apparently reached an agreement: It appears that Germany undertook to work towards further sanctions against Russia if Russia uses the gas pipeline to exert pressure. In return, the US will continue to refrain from imposing further sanctions against the project.

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 license now applies equally to exports of those items to Russian companies, even outside Russia, without a license. There is a general license 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 quicker to move on imposing sanctions on Burma and Russia in recent weeks than the EU. And the lists are not identical. Therefore, companies operating internationally will need to ensure all relevant lists are checked.

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