

EU and US Sanctions

Summary of norms and Application Guidelines for Russia

**AEB Legal Committee,
supported by Baker&McKenzie – CIS, Limited
June 2014**



EU Sanctions

INTRODUCTION

- EU traditionally adopts a 'smart sanctions' policy instead of a complete embargo → targeted trade restrictions directed against specific persons, companies, entities, bodies, industry sectors and/or activities
- Sanctions are included in **decisions** and **regulations**:
 - **Decisions** are only binding on EU Member States → need to be implemented before becoming binding on companies and persons
 - **Regulations** are binding on companies and persons → no implementation required
 - Beware: Often enter into force on day of publication

INTRODUCTION

- More and more persons are becoming subject to sanctions → not only nationals of the 'usual suspect' countries like Iran, Syria and North Korea, but also countries like Egypt, Tunisia, Belarus, etc. **And now – Russia and Ukraine**
- Sanctions are constantly kept under review → need to perform checks on a regular basis: what is permitted today may become prohibited tomorrow and vice versa
- Sanctions imposed by other countries or organizations (U.S., Canada, Switzerland, the United Nations, etc.) are not always similar or in line with EU sanctions

SCOPE OF EU SANCTIONS

- Persons within EU territory (including transit and airspace)
- Persons on board of aircraft or vessels under EU Member State jurisdiction
- Persons with EU Member State nationality, wherever located
- Any legal person, entity or body incorporated or constituted under laws of EU Member State
- Any legal person, entity or body in respect of any business done in EU
- Korean national visiting a branch of Korean entity in Belgium
- Australian national on board of a Lufthansa airplane
- French national working for a Russian entity in Russia
- Dutch entity (including its non-EU branch offices, e.g. in Russia)
- Canadian entity enters into an arrangement with a UAE entity where the financing is dealt with by a UK entity

WHAT SANCTIONS ARE RELEVANT FOR EU ENTITY'S BUSINESS?

- I. Designated Person ('DP') controls
- II. Anti-circumvention clause
- III. Knowledge defense

I. DESIGNATED PERSON CONTROLS - GENERAL

- DPs can be individuals, legal entities or bodies, inside or outside of residence country
- Entities owned or controlled by those listed as DP = DPs
- Sanctions against DPs include:
 - Freeze of funds and economic resources belonging to, owned, held or controlled by DPs
 - Prohibition on making funds or economic resources available, directly or indirectly, to or for the benefit of a DP

I. DESIGNATED PERSON CONTROLS - GENERAL

- Funds: financial assets and benefits of every kind, including, but not limited to cash, bills of lading, credit, debit, cheques, guarantees, bond, dividends, etc.
- Economic resources: assets of every kind, whether tangible or intangible, movable or immovable, which are not funds but which may be used to obtain funds, goods or services
 - EU entity's products or services = economic resources

I. DESIGNATED PERSON CONTROLS - GUIDELINES

- On 30 April 2013 the Council of the European Union published the 'Guidelines on implementation and evaluation of restrictive measures (sanctions) in the framework of the EU Common Foreign and Security Policy'
- Aim of guidelines is to reach a common understanding on the notion of 'ownership and control' by DPs and on the concept of 'making indirectly available of funds and economic resources to DPs'

I. DESIGNATED PERSON CONTROLS GUIDELINES: OWNERSHIP

- Criterion to be taken into account when assessing whether a legal person or entity is owned by another person or entity
- Possession of more than 50% of the proprietary rights of an entity or having majority interest in it
- If this criterion is satisfied: legal person or entity is owned by another person or entity
- However, the fulfilment of the criterion of ownership may be refuted on a case by case basis

I. DESIGNATED PERSON CONTROLS GUIDELINES: CONTROL

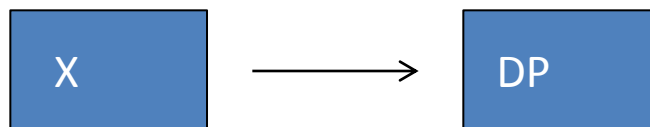


If any of the control criteria are satisfied: legal person or entity is controlled by another person or entity, unless the contrary can be established on a case by case basis. Control criteria include inter alia:

- Having the right or exercising the power to appoint or remove a majority of the members of the administrative, management or supervisory body of such legal person or entity
- Having the right to use all or part of the assets of a legal person or entity
- Managing the business of a legal person or entity on a unified basis, while publishing consolidated accounts
- Controlling alone, pursuant to an agreement with other shareholders in or members of a legal person or entity, a majority of shareholders' or members' voting rights in that legal person or entity
- Having appointed solely as a result of the exercise of one's voting rights a majority of the members of the administrative, management or supervisory bodies of a legal person or entity who have held office during the present and previous financial year
- Sharing jointly and severally the financial liabilities of a legal person or entity, or guaranteeing them
- Having the right to exercise a dominant influence over a legal person or entity, pursuant to an agreement entered into with that legal person or entity, or to a provision in its Memorandum or Articles of Association, where the law governing that legal person or entity permits its being subject to such agreement or provision
- Having the power to exercise the right to exercise a dominant influence referred to in the previous bullet point, without being the holder of that right (including, for example, by means of a front company)

I. DESIGNATED PERSON CONTROLS

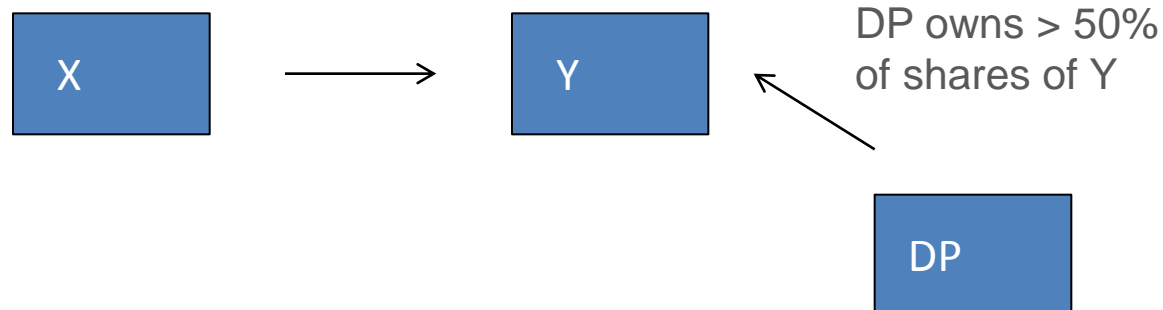
- Directly:



- Indirectly:



- For the benefit of:



I. DESIGNATED PERSON CONTROLS: CONSIDERATION

- Factors to consider in assessing risk of 'indirect' and/or 'to the benefit' of dealings:
 - Shareholders (wholly owned/majority/minority)
 - Directors/managers (control)
 - Nature of products/services (easily transferable)
- Screening
 - Of all parties involved (customer, agent, distributor, bank, freight forwarder, etc.)
 - At various stages in the transaction chain (customer registration, order intake, shipment, etc.)
 - Keep records of screening results and background checks

II. ANTI-CIRCUMVENTION CLAUSE

- This clause reads as follows:

It shall be prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent the measures in Article ...

- 'Restructuring' of certain activities in order to avoid EU sanctions jurisdiction is thus prohibited

III. KNOWLEDGE DEFENSE

- This clause reads as follows:

The prohibitions set out in ... shall not give rise to liability of any kind on the part of the natural or legal persons or entities concerned, if they did not know, and had no reasonable cause to suspect, that their actions would infringe these prohibitions

- Requires due diligence checks to be conducted
- Doing nothing is not sufficient to rely on the knowledge defense



Impact of U.S. Sanctions

U.S. SANCTIONS IMPACT ON NON-U.S. ENTITIES

- Do the U.S. rules apply?
 - U.S. persons (also greencard holders)
 - Products of U.S. origin (also < 100% U.S. content)
 - USD transactions
 - Be aware of indirect U.S. jurisdiction
 - Clauses in financing arrangements
 - U.S. investments

U.S. SANCTIONS FOR RUSSIA/UKRAINE

- Apply to “U.S. Persons”:
 - U.S. companies and their foreign branch offices
 - non-U.S. subsidiary **is not** a U.S. Person
 - U.S. citizens and permanent resident aliens (green card holders), wherever located
 - All persons/entities physically located in the U.S.
- Sanction individuals and entities listed by U.S. Treasury’s Office of Foreign Assets Control (OFAC) as Specially Designated Nationals (SDNs)
- SDN travel ban, asset freeze and prohibition of nearly all forms of U.S. Person involvement in transactions, be it direct or indirect
- **NOTE:** any restrictions on dealing with SDNs extend to entities in which a single SDN holds, directly or indirectly, a 50% or greater ownership interest
 - i.e. no “control” test !

PROHIBITED U.S. PERSON INVOLVEMENT

- Also known as 'facilitation'
- Examples of U.S. Person involvement include:
 - Supply of product/services to third parties with knowledge or reason to know items are destined for a SDN
 - U.S. management approvals/directions for any dealings with SDN
 - Financing, bank guarantees, warranties
 - Referral of SDN orders to non-U.S. persons
 - Negotiation/review of commercial terms/contracts with SDN

PROHIBITED U.S. PERSON INVOLVEMENT

- Certain forms of IT infrastructure support and IT access/services
- Other support (technical, legal, credit review, etc.)
- No facilitation: the non-U.S. subsidiary has to have:
 - The independent authority to enter into and
 - The independent ability to perform a transaction without U.S. Person involvement
 - **BUT:** provision of this authority and ability as a result of U.S. sanctions introduction, without objective business reason = **circumvention**

Compliance Tips

COMPLIANCE CHECKLIST: WHAT?

- What is your product? What are your services?
 - Understand your product
 - Does it fall within a control list?



COMPLIANCE CHECKLIST: HOW?

- For what will/can your product be used?
 - What is (or could be) the end use that the product is being supplied for?
 - Will the supply be caught by a controlled end use?



Compliance Checklist: Whom?

- Whom are you supplying to?
 - Who is your customer?
 - Does your customer raise end use concerns?
 - Is your customer a “sanctioned party”?
 - What about other third parties? (subcontractors, affiliates, end users, directors, parent companies, agents, freight forwarders, etc.)



COMPLIANCE CHECKLIST: WHERE?

- Where are you supplying to?
 - What country is the customer/end user based in?
 - What intermediary countries are involved?
 - Does this raise end use concerns?



Sanctions – local Russian aspects

Risks and considerations of Russia/Ukraine sanctions application

- Russia does not recognize the sanctions applied by U.S., EU and other countries to its citizens and entities
- Termination or suspension of ongoing contracts with Russian SDNs and DPs is viewed in Russia as a breach and entails legal and financial risks:
 - In certain cases – risk of administrative fines for entity and management
 - In certain cases – risk of criminal liability for management
 - In all cases – risk of civil law liability for entity (fines, damages and special performance awards)

Risks and considerations of Russia/Ukraine sanctions application

- Foreign law and dispute resolution venue under a cross-border contract between EU entity and the sanctioned Russian entity may mitigate the risks of compliance with sanctions
- Local contract between a Russian subsidiary of EU entity and the sanctioned Russian entity increases those risks:
 - subject entirely to Russian law and dispute resolution
 - Force Majeure is unlikely to be recognized by the Russian Chamber of Commerce and Industry
 - BUT check whether the Russian subsidiary must follow the sanctions (are any EU/US Persons involved?)

Risks and considerations of Russia/Ukraine sanctions application

- Inclusion of specific sanction clauses (conditions, restrictions and undertakings), similar to export control clauses and compliance clauses, into all new contracts and (to the extent possible) ongoing contracts with Russian parties is highly recommended:
 - U.S. and EU sanctions against Russian individuals and entities are seen to expand over time, so a permitted deal today may become prohibited by sanctions in the future
 - For major Russian business groups and strategic sectors of economy (e.g. energy, banking) the risk is higher
 - A proper sanction clause improves legal defense in case of a dispute with the sanctioned Russian party for suspension of dealing on that ground



EU and US Sanctions. Summary of norms and Application Guidelines for Russia

AEB Legal Committee, supported by Baker&McKenzie – CIS, Limited

June 2014

Disclaimer: This publication is issued by the Legal Committee of the Association of European Businesses (AEB) with support of Baker&McKenzie – CIS, Limited to inform AEB members and other interested parties of legal developments that may affect or otherwise be of interest to them. The publication does not constitute legal or other advice and should not be regarded as a substitute for specific advice in individual cases.

The information in this publication is not exhaustive. While all reasonable care has been taken to prepare it, neither AEB nor Baker&McKenzie – CIS, Limited accepts responsibility for any errors it may contain, whether caused by negligence or otherwise, or for any loss, however caused, sustained by any person that relies on it. Any such person shall consider respective actions (inaction) independently, using proper legal expertise.