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KIRKLAND ALERT

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U.S. Sanctions Update: New Parties and Key Sectors Targeted in Russia, Further Increasing Risks for Global Companies

Companies with commercial ties to Russia, especially its financial, energy and defense sectors, should ensure they understand the impact of these recent changes, as well as future potential risks in this continuously evolving situation.

The U.S. Government has significantly expanded restrictions on dealings by U.S. entities with Russian entities — particularly major Russian banks and energy sector companies. These actions relate to the ongoing conflict in Ukraine and the efforts by the United States, the European Union ("EU") and other governments to try to persuade Russia to end its military engagement on behalf of the separatist movement in Ukraine. The EU also announced an expansion of its sanctions against Russia. Companies with commercial ties to Russia, especially its financial, energy, and defense sectors, should ensure they understand the impact of these recent changes, as well as future potential risks in this continuously evolving situation.

On July 29 and 31, 2014, President Obama, along with the U.S. Department of the Treasury and the U.S. Department of Commerce announced expanded restrictions on U.S. persons and U.S. goods and technology with respect to key sectors of Russia's economy. These announcements follow several other similar measures, on which we reported a few months ago, evidencing the quickly evolving nature of U.S. sanctions targeting Russia and separatist elements in Ukraine.

The U.S. Department of the Treasury's actions relate to executive orders previously issued in March 2014.[1] One of the orders authorized the Secretary of Treasury to identify key sectors of the Russian economy and to impose sanctions on specific persons operating within those sectors. The financial services and energy sectors were recently identified under these sanctions, and the Treasury Department's Office of Foreign Assets Control ("OFAC") established the new Sectorial Sanctions Identifications ("SSI") List on July 16, 2014, creating two tiers of sanctions prohibiting U.S. persons[2] from certain debt and/or equity dealings with listed energy and financial services sector parties.

The SSI list currently contains two directives — Directive 1, applicable to the financial services sector, and Directive 2, applicable to the energy sector.[3] Specifically, Directive 1 prohibits U.S. persons from transacting in, providing financing for, or otherwise dealing in "new" debt[4] with a maturity of longer than 90 days or "new" equity,[5] provided on behalf of, or for the benefit of the listed persons, their property, or their interests in property. Directive 2 prohibits U.S. persons from transacting in, providing financing for, or otherwise dealing in "new" debt of greater than 90 days maturity on behalf of, or for the benefit of those listed persons, their property, or their interests in property. Directive 2 does not currently restrict equity investment.

OFAC's successive announcements[6] have specified that debt or equity is "new" if it is issued on or after the applicable sanctions effective date. Payments and other transactions under existing contracts, formed prior to the effective sanctions date, are permissible. However, if the rollover of existing debt results in the creation of new debt or modification of terms with a maturity of longer than 90 days, this would be a prohibited transaction. Likewise, OFAC has advised that a U.S. person transacting or otherwise dealing in equity issued by an SSI-listed entity prior to the effective date of the sanctions should ensure that these transactions do not involve any "newly" issued equity. Other guidance relating to derivative products and letters of credit also has been provided.

Bills currently pending in Congress propose additional sanctions targeting Russia. Companies doing business in Russia should remain diligent and stay informed to ensure compliance with applicable laws.

The SSI list was expanded on July 29, 2014, to include major state-owned Russian banks. The stated goal of the new sanctions is to significantly limit access by major companies in strategic sectors to medium- and long-term U.S. sources of financing in order to influence the Russian government to cease its present course and engage in a negotiated ceasefire and settlement of hostilities in Ukraine. However, there is also substantial hardship borne by U.S. and other companies that have engagements with Russia, which the U.S. government has sought to balance in part through only imposing restrictions on "new" debt or equity deals.

Additionally, several entities and individuals related to Russia's involvement in Ukraine's Crimean region have been named as blocked parties on OFAC's Specially Designated Nationals and Blocked Persons ("SDN") list, which results in broad prohibitions on any financial transactions with these parties by U.S. persons. For instance, the President of Russian Railways and Russia's state-owned shipbuilding company, United Shipbuilding Corporation, were added to OFAC's SDN list.

The U.S. Department of Commerce also has announced a series of new sanctions, restricting exports to Russia used in the defense and energy sectors. Most recently, export, re-export, or foreign transfer generally are prohibited of certain items that may be used for exploration or production from deepwater, Arctic offshore, or shale projects that have the potential to produce oil. U.S. officials acknowledge that these sanctions may not prevent Russian companies from selling oil and gas, but rather are intended to hamper the development of long-term, technical capabilities in this strategic sector. Many related entities also have been added to Commerce's Denied Parties List, to which controlled exports generally are prohibited. The U.S. Department of State also has issued restrictions under the International Traffic in Arms Regulations ("ITAR") on exports to Russia and parts of Crimea, including the export or re-export of any high-technology defense articles or services that could support Russia's military capabilities.

U.S. government officials repeatedly advise that sanctions may be expanded at any time, including the addition of the SSI parties, or other parties, to the SDN list. Additionally, bills currently pending in Congress propose additional sanctions targeting Russia. Companies doing business in Russia should remain diligent and stay informed to ensure compliance with applicable laws.

[1] Executive Order 13660 (March 10, 2014); Executive Order 13661 (March 19, 2014); Executive Order 13662 (March 24, 2014).

[2] The term "U.S. person" means any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States. Executive Order 13662 (March 24, 2014), Sec. 6(c).

[3] Directive 1 currently includes Gazprombank OAO, VEB, Bank of Moscow, Russian Agricultural Bank (A.K.A. Rosselkhozbank), VTB Bank OAO; Directive 2 currently includes OAO Novatek and Rosneft.

[4] The term debt includes bonds, loans, extensions of credit, loan guarantees, letters of credit, drafts, bankers acceptances, discount notes or bills, or commercial paper. OFAC Frequently Asked Question No. 371 (available at http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx).

[5] The term equity includes stocks, share issuances, depositary receipts, or any other evidence of title or ownership. OFAC Frequently Asked Question No. 371 (available at http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx).

[6] *See e.g.*, OFAC Frequently Asked Question Nos. 371 - 394 (available at http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx).

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