

KIRKLAND ALERT

October 31, 2017

As Investigations Continue in Washington, U.S. State Department Issues Sanctions Guidance on Russia's Defense and Intelligence Sectors

On October 27, 2017, the U.S. State Department released a list of 39 Russian entities identified as being involved in the defense and intelligence sectors, and as a result, U.S. and non-U.S. companies may face sanctions for doing business with these listed entities.¹ The release of the list was mandated by the U.S. Congress pursuant to a law intended to punish Russia for its apparent interference in the 2016 presidential election and other activities. While this list puts companies on notice as to certain Russian counterparties with whom there is a heightened risk of conducting business, it is not exhaustive and does not affect existing export control restrictions or list-based sanctions. Companies will want to check carefully whether they may be doing business with Russian counterparties that have been or could be identified under the articulated criteria.

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The View from Washington

The announcement comes after the October 1, 2017, deadline imposed on the president under the *Countering America's Adversaries Through Sanctions Act of 2017* ("CAATSA" or the "Act") to specify which individuals or entities were considered part of Russia's defense and intelligence sectors, and thus would be targeted by sanctions under the Act. The Act, which received broad bipartisan support and also included new sanctions on Iran and North Korea, was seen at the time [a way of forcing the president's hand on taking action in response to Russia's apparent interference in the election](#). On October 25, 2017, the House Committee on Foreign Affairs sent a letter to President Trump stating that the fact the president had as yet not issued the guidance "*ignores the clear will of overwhelming bipartisan majorities that passed this legislation in Congress.*"²

Features of the Russia Sanctions Guidance

Beginning January 29, 2018, CAATSA requires the imposition of five or more sanctions on persons determined to have knowingly engaged in a "significant transaction" on or after July 28, 2017, with a person that is part of or operating for or on behalf of the defense or intelligence sectors of the government of the Russian Federation. State Department officials have recognized that this is a deliberately "flexible standard," subject to interpretation. Sanctions can include prohibiting loans from

U.S. financial institutions; denying Ex-Import Bank guarantees; denying U.S. export licenses; and prohibiting U.S. government contracts.

Of note, even though the vast majority of the entities the State Department identified were already listed on the Department of the Treasury's Specially Designated Nationals and Blocked Persons List ("SDN List") or Sectoral Sanctions Identification List ("SSI List") such that U.S. companies already could not deal with them, the secondary sanctions under CCATSA now make it such that non-U.S. companies also may not engage in significant transactions with them.

The guidance identifies the initial list of Russian defense- and intelligence-related parties and the criteria the U.S. government will apply in determining whether to sanction parties for doing business with them:

- *Significant Transactions.* Only transactions considered "significant" are sanctionable. However, the Act does not include a definition of "significant transaction," and the State Department guidance does not provide a dollar threshold. Rather, the State Department has discretion to determine whether the threshold is met and indicated it will consider the totality of the facts and circumstances surrounding the transaction. The State Department will weigh various factors on a case-by-case basis, including "*the significance of the transaction to U.S. national security and foreign policy interests, in particular whether it has a significant adverse impact on such interests; the nature and magnitude of the transaction; and the relation and significance of the transaction to the defense or intelligence sector of the Russian government.*"³
- *Military Allies.* Purchasing Russian-origin military equipment, spare parts and related supplies may subject a party to sanctions if considered to be a "significant transaction." However, the State Department indicated that CCATSA itself acknowledges, e.g., the importance of "unity with European and other key partners on sanctions implemented against the Russian Federation" to counter its actions in Ukraine.⁴ It added that the United States intends to work with its allies and partners to help them avoid engaging in potentially sanctionable activity while strengthening military capabilities used for cooperative defense efforts. In a briefing on the sanctions, State Department officials indicated that the sanctions are supportive of NATO's policy of "reducing reliance on old Soviet and Russian military equipment."⁵ As such, they may serve to increase sales of U.S. military items, itself an important means of fostering strategic alignment by means of defense cooperation.
- *Federal Security Service.* One of the key features of the guidance is its listing of Russia's Federal Security Service (FSB). Though the FSB is considered to be today's version of the KGB, it also plays a prominent role in several commercial sectors of the economy, such that its listing raises the prospect of sanctions on companies engaging in a wide range of business. Perhaps in recognition of this, the State Department clarified that companies likely would not face sanctions if engaging in transactions and making payments "to comply with rules and regulations administered by the Federal Security Service."⁶ Thus, it appears

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multinational companies may still engage in certain regulatory matters with the FSB, e.g., to comply with Russia's licensing requirements on the importation, distribution and use of encryption products. However, business transactions with the FSB as a commercial counterparty subject companies to added sanctions risk.

- *Corporate Officers.* In addition to sanctions on companies, the Act authorizes sanctions on their principal executive officer or officers, or persons performing similar functions and with similar authorities as such officer or officers. This action is consistent with recent U.S. enforcement focus on individual responsibility (including the well-known "[Yates Memo](#)" issued by the U.S. Department of Justice) and is expected to have a significant chilling effect on business with Russia.

Key Takeaways

- The State Department guidance does not claim to be comprehensive, and it is possible entities will be added to the list. Engaging in a significant transaction with an entity in the Russian defense or intelligence sector, even if it is not currently listed, runs the risk of subjecting U.S. and foreign companies and their principal officers to potential future sanctions.
- Given the lack of clarity on the definition of "significant," many types of transactions likely will entail a heightened degree of risk and increased effort to ensure compliance with the Russia sanctions. This is particularly true given that the U.S. government may view a transaction to have importance from a policy perspective even if it does not necessarily involve a large amount monetarily.
- As Russia-related sanctions are subject to ongoing revision, companies pursuing business in or with Russia should regularly perform enhanced diligence of potential contractual counterparties, including on their beneficial owners.
- As the Russia-related Congressional and other investigations continue in Washington, corporate boards, general counsel and compliance officers will want to remain mindful of the reputational, as well as legal, risks that violations of Russia sanctions in particular present at this time.

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- 1 CAATSA Section 231(d) Defense and Intelligence Sectors of the Government of the Russian Federation, U.S. Department of State (Oct. 27, 2017).
 - 2 Letter to The President, U.S. House of Representatives (Oct. 25, 2017) available at <https://democrats-foreignaffairs.house.gov/sites/democrats.foreignaffairs.house.gov/files/10.25.17.%20HFAC%20Democrats%20Letter%20to%20POTUS%20on%20Failure%20to%20Enforce%20Russia%20Sanctions.pdf>.
 - 3 Public Guidance on Sanctions with Respect to Russia's Defense and Intelligence Sectors Under Section 231 of the Countering America's Adversaries Through Sanctions Act of 2017, U.S. Department of State (Oct. 27, 2017), <https://www.state.gov/t/isn/caatsa/275118.htm> (hereinafter "Public Guidance on CAATSA").
 - 4 *Id.*
 - 5 Briefing on Sanctions With Respect to Russia's Defense and Intelligence Sectors Under Section 231 of the Countering America's Adversaries Through Sanctions Act of 2017, U.S. Department of State (Oct. 27, 2017), <https://www.state.gov/r/pa/prs/ps/2017/10/275164.htm>.
 - 6 Public Guidance on CAATSA.
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If you have any questions about the matters addressed in this *Kirkland Alert*, please contact the following Kirkland authors or your regular Kirkland contact.

Mario Mancuso, P.C.
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
www.kirkland.com/mmancuso
+1 202 879 5070

Zachary S. Brez, P.C.
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
www.kirkland.com/zbrez
+1 212 446 4720

Michael S. Casey
Kirkland & Ellis International LLP
30 St Mary Axe
London EC3A 8AF
www.kirkland.com/mcasey
+44 20 7459 2255

Sanjay J. Mullick
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
www.kirkland.com/smullick
+1 202 879 5111

Joanna Ritcey-Donohue
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
www.kirkland.com/jritcey-donohue
+1 202 879 5980

Ariel V. Lieberman
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
www.kirkland.com/alieberman
+1 202 879 5215

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