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ECONOMIC SANCTIONS

U.S. Targets Putin's Inner Circle: Five Takeaways for Companies and Investors



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On April 6, 2018, the U.S. Department of the Treasury Office of Foreign Assets Control ("OFAC") imposed new sanctions, "blacklisting" individuals and entities associated with the Russian government. Responding to what Secretary of the Treasury Steven Mnuchin called Russia's "range of malign activity around the globe," the new sanctions ban commercial engagements by U.S. persons with these individuals and entities, which have deep and complex business and investment relationships with numerous U.S. and non-U.S. companies, both directly and through subsidiaries, joint ventures and other structures. Though directed at Russia, the new restrictions will have collateral impacts on non-Russian companies and investors in the United States, Europe and across the globe-- all of which will need to deploy multi-layered compliance efforts in order to respond to the evolving sanctions landscape and its complexities.

The View From Washington

The new sanctions were issued pursuant to the Countering America's Adversaries Through Sanctions Act ("CAATSA"), and follow on OFAC's January 29, 2018 release of a report identifying Russian "oligarchs," senior political figures and parastatal entities considered close to President Putin. At that time, OFAC emphasized that the report did not constitute a sanctions list, but also indicated that the report (and in particular, its classified annex) could result in future sanctions, so that the new measures imposed were not surprising. The recent U.S. and multinational condemnation of Russia's involvement in the poisoning of a former Russian spy and his daughter in London, along with allegations of chemical weapons use in Syria, also have engaged U.S. government stakeholders' attention and demands for action. In total, since the beginning of the Trump Administration, 189 persons and entities have been designated under Russia-related sanctions authorities. In the absence of policy changes from the U.S. and Russian governments, OFAC is expected to continue to ratchet up sanctions targeting Russia.

Summary of Sanctions Targeting Russia's Government and Elites

The sanctions were imposed on prominent targets, and, subject to narrow exceptions, with immediate effect. The "oligarchs" targeted by the new sanctions predominantly operate in Russia's energy sector. That being said, many of their business interests representing a broader array of commercial interests (e.g., aluminum, asset management, telecom) also were targeted.

Designation of Individuals and Entities

OFAC designated seven Russian oligarchs and 12 companies that such individuals own or control, 17 senior Russian government officials, one a state-owned Russian weapons trading company, and the Company's subsidiary, a Russian bank. All but one of these individuals and entities were placed on OFAC's List of Specially Designated Nationals and Blocked Persons (the "SDN List") pursuant to Executive Orders 13661 and 13662, as codified by CAATSA. One company and its subsidiary were designated for having contributed to the crisis in Syria through sale and transfer of Russian military equipment to support the Syrian government. As a result of these designations, U.S. persons are prohibited from engaging in transactions with them or in entities in which they hold a majority ownership, directly or indirectly. In practice, even non-U.S. persons may decide not to deal with them out of concern of exposure to "secondary sanctions" and in the interests of maintaining relationships with U.S. counterparties and access to the U.S. market.

Issuance of General Licenses

Concurrent with the sanctions, OFAC issued two General Licenses to try to minimize the potential adverse consequences of the new sanctions for U.S. persons and U.S. allies, though the allowances provided are both limited in scope and time-bound, focused on completing a wind-down in one or two months:

- General License 12 authorizes activities and transactions with twelve designated companies and other entities in which such companies hold a 50% or greater interest "ordinarily incident and necessary to the maintenance and wind-down of operations, contracts, or other agreements, including the importation of goods, services, or technology into the United States."
 - New business relationships are not permitted; the relevant commercial arrangements must have been in place before April 6, 2018.
 - General License 12 provides for a 60-day wind-down period, and expires on June 5, 2018.
- General License 13 authorizes activities and transactions "ordinarily incident and necessary to divest or transfer debt, equity, or other holdings" in three designated companies "to a non-U.S. person, or to facilitate the transfer of debt, equity, or other holdings in [the three designated companies] by a non-U.S. person to another non-U.S. person."
 - General License 13 does not include authorization to divest or transfer debt, equity, or other holdings of entities in which the three designated companies hold a 50% or greater interest, which are blocked by operation of law under OFAC's "50% Rule."
 - General License 13 provides for a 30-day term, and expires on May 7, 2018.

It is important to appreciate that OFAC issued the General Licenses precisely because the sanctions do not provide for grandfathering of pre-existing relationships. For example, OFAC's new FAQs make clear that U.S. person employees of designated companies will be unable to continue working at such companies and can engage only in limited activities to wind down their employment pursuant to the terms of General License 12. Absent authorization under one of the new general licenses (which itself would be time-limited), U.S. persons will need to seek a specific license from OFAC to continue existing relationships with designated parties.

Key Takeaways

- 1. U.S. persons, including financial institutions, are now broadly prohibited from directly or indirectly transacting with the newly-sanctioned parties -- except where authorized by one of the general licenses.** Designation as an SDN effectively cuts off a party from the U.S. financial system and transactions with U.S. persons, and many non-U.S. financial institutions avoid transacting with SDNs in order to preserve their own access to U.S. dollar-denominated transactions.
- 2. Non-U.S. persons face exposure to secondary sanctions for knowingly facilitating "significant transactions" for or on behalf of the newly-designated parties.** This extension of potential exposure increases the financial impacts of the new sanctions by making it more likely that non-U.S. companies will cut off business with designated parties in order to avoid being designated themselves.
- 3. Compliance with these new measures will require enhanced efforts by many companies and investors.** Such steps would include robust pre-contractual due diligence and contractual protections, including assessment of direct and indirect beneficial ownership of contractual counterparties, and an ongoing assessment of new and different risk vectors and appropriate responses.
- 4. OFAC is highly interested in gathering information about U.S. person engagement with sanctioned individuals and entities.** Both of the General Licenses issued in connection with the new sanctions require U.S. persons participating in transactions authorized under the GLs to report certain information to OFAC within ten business days following the expiration of each such GL. Reports to OFAC must include the "names and addresses of parties involved, the type and scope of activities conducted, and the dates on which the activities occurred."
- 5. The animating purpose of U.S. sanctions targeting Russia is no longer limited to Russia's annexation of Crimea.** Secretary Mnuchin's remarks on the new sanctions made clear that the U.S. government's concerns extend to Russia's malign activities in undermining democracy, cyber interference, and aggression in Syria. That

these activities have broad relevance for both the U.S. and its allies may help to lay the groundwork for additional sanctions going forward.

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