Armstrong Teasdale

July 19, 2022 • Publications • www.atllp.com

RUSSIAN SANCTIONS: COMPLIANCE CONSIDERATIONS FOR GLOBAL COMPANIES ACROSS MULTIJURISDICTIONAL SANCTIONS REGIMES

ACC St. Louis Newsletter

PEOPLE
Jennifer A. Schwesig

SERVICES AND INDUSTRIES
International

With new and rapidly changing sanctions amid the Russia-Ukraine crisis, companies doing business in both the U.S. and other countries face greater challenges than simply complying with sanctions in their "home" country. For multinationals, sanctions compliance necessitates considering the simultaneous application of varied and potentially conflicting sanctions regimes. Adding to this challenge is the fact that U.S sanctions laws (as well as those of other countries) can apply to activities occurring outside of the U.S. or by non-U.S.-based companies or individuals. Given the historically far-reaching nature of U.S. sanctions regimes (such as the Iranian and Cuban embargos), the U.S. typically has taken a more comprehensive approach. As a result, it made sense for U.S.-based companies to focus more heavily on compliance with U.S. sanctions, especially given the level of exposure and associated penalties. While the expansive U.S. approach provides a model for compliance by placing emphasis on adherence to the stricter U.S. standards, there have been many instances where extraterritorial enforcement of U.S. sanctions regimes results in violations of other countries' laws or vice versa, making compliance challenging[i].

In addition to the U.S., many other major countries have sanctioned Russia to varying degrees, arguably subjecting it to the most coordinated multilateral sanctions regime to date. Some of these sanctioning countries include Australia, Canada, the European Union (all member states), Japan, New Zealand, Norway, Singapore, South Korea, Switzerland, Taiwan and the United Kingdom (among others). While global Russian sanctions do not yet amount to a total prohibition on doing business in Russia. Instead, for most countries, "Russian sanctions" include both broad transactional prohibitions in designated sectors as well as more narrow sanctions freezing the assets of individuals,

entities, and institutions with close connections to the Russian government (with a focus on the latter). Despite the concerted global effort, it is still important to comply with U.S. law while at the same time recognizing the subtle differences between sanctions approaches and examining how certain jurisdictional hooks could require the application of foreign laws (more of a "yes, and" approach).

In the U.S., the sanctions are largely a combination of Executive Orders (EOs) and general codifying legislation[ii] which currently include the following restrictions (among others): (1) identifying financial institutions (many major Russian banks), other entities and individuals as Specially Designated Nationals (SDN) and prohibiting all forms of business therewith[iii]; (2) prohibitions on "new investment" in Russia as well as the provision of certain services to Russia[iv]; (3) robust trade controls designed to stop the flow of dual-use (military/civil) commodities of U.S. origin, or produced with substantial reliance on U.S.-origin technology, to Russia; (4) blocking imports of certain luxury and other goods into the U.S.; (5) trade and investment in key areas based on focused sectoral sanctions (oil and gas, energy); (6) financial sanctions related to debt and equity restrictions; and (7) embargos against the Russian-occupied Donetsk and Luhansk (and Crimea per prior sanctions) regions of Ukraine.

Against the seemingly similar backdrop of U.S. sanctions, there continue to be instances where business transactions that are permitted under U.S. sanctions are prohibited under the EU, U.K. or other countries' sanctions regimes. One key area of difference is with the individuals and entities placed on the U.S. SDN list (or other restricted parties lists) when compared to those of other countries' sanctions lists. While the U.K. and the U.S. (and the EU as well as Switzerland) have generally collaborated on specific sanctions activity, the U.K. has been more aggressive in freezing the assets of a number of Russian entities and individuals that remain unsanctioned by the U.S. Further, the U.K. has adopted an "urgent designation procedure" to enable the U.K. to designate individuals and entities, if they have been sanctioned by the U.S., EU, Australia, Canada and others, under a similar sanctions regime and the relevant U.K. government Minister considers it to be in the public interest to use this procedure. Therefore, it is critical that U.S.-based multinationals confirm (with effective due diligence) that none of the parties with whom they are doing business (either directly or indirectly) are sanctioned in any jurisdiction that may have a connection with the transaction (not just the U.S.).

While the U.S, the U.K. and EU member states have "similar" sanctions imposed against Russia, the question of extraterritorial application can differ among countries, also requiring a jurisdiction-by-jurisdiction analysis. Generally, U.S. primary sanctions prohibit transactions by "U.S. persons," defined as any U.S. citizen, permanent resident, entity organized under the laws of the U.S., or any jurisdiction within the U.S., or any person in the U.S.[v] Further, the concept of U.S.-based jurisdiction also includes U.S.-based

property of foreign parties or that which comes within the possession or control of any U.S. person anywhere in the world.[vi]

This view is not unlike the EU, where sanctions typically apply: (1) within the territory of the EU, including its airspace; (2) on board any aircraft or vessel under the jurisdiction of an EU member state; (3) to EU nationals, wherever they are located; (4) to any legal entity incorporated under the law of an EU member state, whether that entity is situated inside or outside the EU; and (5) to any legal entity in respect of business done in whole or in part within the EU. In the U.K., sanctions are binding on both individuals and legal entities within (or undertaking activities in) the U.K., as well as U.K. persons (U.K. nationals and entities incorporated under the law of the U.K.) wherever they may be in the world. The U.K. also has additional jurisdictional reach by introducing a new public "Register of Overseas Entities" that will require an "overseas entity," or non-U.K. entity, with a "relevant interest" in U.K. land to identify "registrable beneficial owners" and register with Companies House.[vii]

The U.S., however, takes things a step further than the obvious territorial and citizenship connections. Arguably, the U.S. has the farthest-reaching jurisdictional hooks when it comes to the extraterritorial application of U.S. sanctions, particularly with regard to U.S.-owned or controlled foreign companies and to reexports of U.S.-origin items[viii] by foreign persons. Further, primary sanctions apply not only to U.S. persons, but also to transactions where there is U.S. "nexus," a term which has been broadly interpreted by the Office of Foreign Assets Control (OFAC), the primary body tasked with enforcing U.S. sanctions. In contrast, the EU sanctions are narrow in application, generally requiring compliance only by those with a clear EU nexus, jurisdiction, nationality or incorporation.

As is apparent from a number of OFAC's enforcement actions, a more tangential U.S. "nexus" can be created in a number of different ways, particularly where the foreign party has a requisite level of contacts with the U.S., such as: (1) engaging in transactions involving U.S. dollars; (2) dealing in U.S. products, software or technology; (3) in the case of foreign subsidiaries or partners, shared information technology infrastructure or other shared or inter-company services; (4) under "secondary" sanctions (i.e., sanctions that specifically apply to non-U.S. parties) even if the foreign party has no contacts with the U.S.[ix];and (5) for foreign persons providing material support or assistance to or facilitating transactions with certain parties that are subject to sanctions.

In the last instance, the risk of facilitation is important to mitigate, particularly when it occurs overseas. Facilitation of trade with sanctioned countries is illegal under U.S. law even if the transaction is legal in the foreign jurisdiction where it occurs.[x] Additionally, a nexus can be created where a U.S. person is assisting or approving a transaction with a sanctioned party (or redirecting a transaction from a U.S. person to a non-U.S. person to avoid sanctions). U.S. persons may

not facilitate sanctions violations, which means a U.S. entity may not indirectly support a transaction that they themselves could not conduct directly. A simple example would be using a foreign subsidiary to engage directly with a sanctioned party, while the U.S. parent supplies the needed materials to the subsidiary, or a parent company otherwise approves or finances a transaction. The U.K. also has a somewhat broad interpretation of circumvention where the act in question can constitute assisting or otherwise facilitating a breach of sanctions.

With respect to the Russian sanctions, if a proposed transaction does not involve any U.S. nexus or facilitation and an SDN-listed entity or individual is only subject to primary sanctions, the sanctions may not automatically apply to that transaction or activity and a non-sanctioned entity may be able to carry out the transaction or activity with the SDN-listed entity. This differs from certain U.S. embargo programs (i.e., Iran and Cuba) where mere ownership or control of a foreign entity triggers the U.S. jurisdictional tag. This is, however, a very slippery slope that requires careful review before assuming that there is no nexus or facilitation and proceeding with the transaction.

KEY TAKEAWAYS – SO WHAT DOES THIS ALL MEAN IN REAL TIME?

As evidenced above, global companies face considerable challenges when implementing a risk mitigation strategy that accounts for the intricacies of overlapping sanctions programs and the extraterritorial application of sanctions to foreign-based activities. Further, complicating matters is the need to manage entire networks of subsidiaries, customers, and vendors across multiple jurisdictions. While a comprehensive compliance program is necessary, here are some key takeaways:

- First and foremost, pay attention to sanctions laws in all countries where you are doing any form of business (not just where you have physical entities). Just because a transaction may seem lawful in the home country jurisdiction does not mean it is lawful everywhere. Compliance programs should be jurisdictionally tailored instead of one-U.S.-size-fits-all.
- Significant due diligence is required on all parties to the transaction including, without limitation, screening against the sanctions lists in all countries involved in the transaction (even if one country does not have a prohibition, others might). In some jurisdictions like the U.S., “sanctioned parties” also include entities owned 50% or more by sanctioned individuals or entities, even if the primary entity is not otherwise sanctioned. This 50% rule also significantly differs between jurisdictions. As such, there is a need to “look behind” the parties to the transaction and identify any possible connection there may to Russia or sanctioned parties (particularly if that connection is occurring

through a third country).

- Determine whether there is a potential U.S. nexus as well as any other "jurisdiction hooks" for other countries involved, either directly or indirectly, in the transaction. While certain U.S. subsidiaries may be in jurisdictions not otherwise subject to sanctions, any U.S. involvement in a prohibited transaction could amount to a potential nexus or facilitation and a violation.
- If an activity is prohibited under any country's sanction program, a license is likely required (either General or Specific) before engaging in any aspect of the transaction (including discussions). All prohibited activities must be ceased until appropriate licenses are obtained. Further, a party seeking a license may require additional licenses across multiple jurisdictions. One license may not be enough.
- Finally, it is clear that many countries are focused on Russia and are heavily focused on enforcing violations. Grounds for violations as well as penalties differ significantly from country to country.[xi] The only thing worse than a violation in one country is violations in multiple countries.

[i] Violations can occur by complying with U.S. law to the exclusion of applicable foreign laws, In addition, compliance with U.S. laws can lead to separate violations. Examples include: (a) EU blocking sanctions where EU persons can be found in breach of the Regulation even if they voluntarily comply with U.S. sanctions and are not subject to any direct orders or enforcement proceedings by U.S. authorities; and (b) Canada, like certain other countries, considers extraterritorial measures like a U.S. subsidiary's compliance with the U.S. Cuban sanctions to be a violation of its sovereignty. Further, under U.S. boycott laws, the U.S. persons cannot comply with boycotts on countries that the U.S. is not otherwise boycotting (e.g. anti-boycott laws).

[ii] Countering America's Adversaries Through Sanctions Act (CAATSA); Ukraine Freedom Support Act of 2014 (UFSA); Support for Sovereignty, Integrity, Democracy & Economic Stability of Ukraine Act 2014; EOs implemented under the International Emergency Economic Powers Act (IEEPA) (50 U.S.C. 1701 et seq.), in particular, EOs 14024 (and Directives 1A-4), 14066, 14068, and 14071; Russian Harmful Foreign Activities Sanctions Regulations to implement EO 14024 (31 C.F.R. 589).

[iii] Some sanctioned individuals or entities are placed on OFAC's Specially Designated Nationals and Blocked Persons (SDN) List. This is not the only sanctions list, and the consolidated lists can be found here: https://www.trade.gov/consolidated-screening-list. The SDN list is significant, however, because OFAC prohibits all transactions between those on the SDN

list and U.S. individuals and companies that fall under the scope of a "nexus" to U.S. jurisdiction. Further, all property and interests of the SDN-listed entity or individual which fall under U.S. jurisdiction are blocked, including companies which are majority owned by the SDN-listed entity or individual.

[iv] EO 14071 which currently includes accounting services, trust and formative services, auditing services, and management consulting. The EO Determination expressly excludes entities in Russia owned or controlled by U.S. persons or wind down services in connection with divestment for a limited period of time (see also General Licenses 35 and 35).

[v] See 31 CFR§ 589.339.

[vi] See 31 CFR§ 589.331.

[vii] Per the Economic Crime (Transparency and Enforcement) Act 2022 (U.K. Act.)

[viii] It is important to take note of the U.S. Foreign Direct Product (FDP) rule, whereby certain entirely foreign-produced products may fall under U.S. jurisdiction if they use or are otherwise manufactured on equipment or in facilities using certain U.S. technology or software. The FDP rule is currently suspended for countries that have imposed sanctions on Russia similar to the U.S.

[ix] OFAC may also impose "secondary sanctions" on non-U.S. companies, even with no U.S. nexus to the activity. Under secondary sanctions, a non-U.S. company may be restricted from U.S. markets or the U.S. financial system if it engages in certain conduct related to Russia.

[x] See 31 CFR 589.414.

[xi] The U.K. Act enables HM Treasury's Office of Financial Sanctions Implementation (OFSI) to impose monetary penalties on a "strict liability" basis by removing the requirement that people must have known or suspected that they breached UK financial sanctions to impose such a penalty.