

Sanctions, Counter-Sanctions and Anti-Corruption Trends in Russia: Doing Business in the Current Climate

May 16, 2019



Agenda and Speakers

US Sanctions



Dan Waltz
Partner
Washington DC

Russia Counter-sanctions



Patrick Brooks
Partner
Moscow



Sergey Treshchev
Partner
Moscow

Anti-corruption Trends



Kristina Arianina
Senior Associate
Washington DC



US Sanctions

Dan Waltz, Partner, Washington DC

US Sanctions Targeting Russia

- US sanctions targeting Russia fall into two broad categories:
 - “Primary” sanctions prohibit “US Persons” from engaging in certain actions or transactions. They are implemented by the Office of Foreign Assets Control (OFAC) within the US Department of Treasury.
 - “Secondary” sanctions can be imposed against non-US Persons if they engage in activities US law defines as “sanctionable,” even in the absence of any US nexus.

Primary Sanctions – Embargo of the Crimea Region

- Executive Order (EO) 13685 (Dec. 19, 2014) prohibits:
 - Imports into the US of goods, services or technology from Crimea;
 - Exports of goods, services or technology from the US or by US Persons to Crimea;
 - New investments in Crimea by US Persons; and
 - Any approval, financing, facilitation or guarantee by a US Person of any such transaction by a foreign person.
- Pursuant to a General License, US Persons can export food, medicine and medical devices to Crimea.
- Otherwise, unlicensed trade or transactions are generally prohibited.

Primary Sanctions - SDNs

- The US has designated as “Specially Designated Nationals” (SDNs) many Russian companies and individuals, including several Russian “oligarchs.”
- Property in which an SDN has an interest in the possession or control of a US Person is “blocked.”
- US Persons may not deal with SDNs.
- SDNs can’t initiate or receive electronic funds transfers denominated in US dollars.
- The OFAC website includes an SDN search engine. Available at: <https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx>.

Primary Sanctions - Sectoral Sanctions (the SSI List)

- Pursuant to EO 13662 (Mar. 20, 2014), OFAC also created the Sectoral Sanctions Identification (SSI) List.
- OFAC places entities on this list pursuant to Directives targeting specific sectors of the Russian economy.
- There are currently 4 Directives in place.
- SSI List entities are not SDNs. Their US property is not blocked and US persons can engage in many types of transactions with them. Each SSI List Directive prohibits US Persons from engaging in only limited categories of transactions.

Sectoral Sanctions (the SSI List)

- US Persons may not:
 - Transact in, provide financing for, or otherwise deal in ***new debt*** of: (1) greater than 90 days maturity if issued on or after July 16, 2014 and before September 12, 2014; (2) greater than 30 days maturity if issued on or after September 12, 2014 and before November 28, 2017; or (3) greater than **14 days** if issued on or after November 28, 2017 or ***new equity*** with a ***Russian financial institution*** on the SSI List [**Directive 1**];
 - Transact in, provide financing for, or otherwise deal in ***new debt*** of: (1) greater than 90 days maturity if issued on or after July 16, 2014 and before November 28, 2017; or (2) greater than **60 days** maturity if issued on or after November 28, 2017 with a ***Russian energy sector entity*** on the SSI List [**Directive 2**];
 - Transact in, provide financing for, or otherwise deal in ***new debt*** of greater than **30 days** maturity with ***Russian defense sector entities*** on the SSI List [**Directive 3**].

Sectoral Sanctions (the SSI List)

- Debt or equity is considered “new” if it is issued after the date the entity was sanctioned.
- The prohibition on dealing in “new debt” was intended primarily to cut off access to US debt markets.
- For a US vendor of goods or services to a sanctioned entity, one spin-off consequence is that payment must be received within the allowable time “window” established under the applicable SSI List Directive.
- For sales of goods, the “clock” begins to run when title transfers to the buyer.
- For sales under subscription agreements, long-term contracts with progress payments, etc., the “clock” begins to run when the invoice is issued.
- Many US vendors are simply requiring “cash in advance.”

Sectoral Sanctions (the SSI List)

- US Persons may not:
 - Provide, export, or re-export, directly or indirectly, goods, services (except financial services), or technology in support of exploration or production for deepwater, Arctic offshore, or shale projects that:
 - (1) have the potential to produce oil in the Russian Federation or maritime area claimed by the Russian Federation and extending from its territory that involve a Russian energy sector entity sanctioned under Directive 4; or
 - (2) are initiated on or after January 29, 2018, that have the potential to produce oil in any location, and in which any Russian energy sector entity sanctioned under Directive 4 has:
 - (a) a 33 percent or greater ownership interest; or (b) an ownership of the majority of voting interests [**Directive 4**].

OFAC's "50% Rule"

- The US sanctions that apply to an SDN apply equally to any entity owned 50% or more by an SDN (or a combination of SDNs).
- The US sanctions that apply to an SSI List entity apply equally to any entity owned 50% or more by one or more SSI List entities sanctioned under the same Directive.
- These sanctions then cascade down the corporate chain.
- OFAC's 50% rule makes it important to conduct due diligence on contractual counterparties to ensure that they are not subjected to US sanctions due to ownership by an SDN or an SSI List entity.

OFAC Sanctions – Who is Subject?

- “US Persons”
 - US citizens and residents – wherever located
 - Companies incorporated under US law
 - Their foreign (unincorporated) branch offices
 - Persons physically located in the US
- US Persons may not “facilitate” sanctioned transactions. Thus, a non-US Person must avoid involving any US Person if engaging in a transaction prohibited to US Persons.

Application to Non-US Persons: “Causing” a Violation

- OFAC’s regulations prohibit not only the unlicensed export of products, but also the unlicensed export of services.
- A US bank that clears a USD-denominated funds transfer to or from an embargoed country or an SDN is deemed to have exported financial services to that sanctions target.
- Non-US banks have paid billions of dollars in penalties for “causing” US banks to process USD-denominated funds transfers (the non-US banks had “stripped” all references to the embargoed source of the funds from the SWIFT messages that were sent to US clearing banks).
- This same “causing” theory has also been applied to persons other than banks.

Illustrative Penalty Actions

- Lloyd's TSB (2009, \$350 million)
- Credit Suisse (2009, \$536 million)
- ABN Amro Bank N.V. (2010, \$500 million)
- Barclays Bank (2010, \$298 million)
- ING Bank N.V. (2012, \$619 million)
- Standard Chartered Bank (2012, 2014 and 2019, \$2 billion)
- HSBC (2012, \$1.9 billion)
- BNP Paribas (2014, \$8.9 billion)
- Commerzbank (2015, \$1.45 billion)
- Credit Agricole (2015, \$787 million)
- Societe Generale (2018, \$1.34 billion)
- UniCredit (2019, \$1.3 billion)
- The size and number of these penalties have caused banks worldwide to avoid funds transfers involving sanctioned countries or persons.

Application to Non-US Persons: “Supporters”

All four of the EOs underlying the Russia-/Ukraine-related Sanctions authorize the designation of persons determined to have “materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of” previously sanctioned SDNs.

OFAC has interpreted its authority to sanction persons for “supporting” previously sanctioned SDNs quite liberally. Even companies engaged in arms-length transactions with SDNs have been sanctioned as “supporters.”

US “Secondary” Sanctions

- US secondary sanctions target sanctioned countries but do so by authorizing the imposition of sanctions against foreign persons.
- US law doesn't apply to such companies, so US secondary sanctions don't “prohibit” anything.
- It follows that secondary sanctions, if imposed, do not represent “penalties” for “violations” of US law.
- The US (in its view) is simply withdrawing privileges that it normally extends to non-US companies (e.g., travel privileges and market access).

US “Secondary” Sanctions

- Non-US Persons can be sanctioned if they:
 - Facilitate a significant transaction or transactions for or on behalf of any person subject to US sanctions imposed with respect to the Russian Federation or, if an individual, a family member of such a person;
 - For foreign financial institutions, facilitate a significant financial transaction on behalf of any SDN that has been designated under OFAC’s Russia/Ukraine program.
 - Engage in a significant transaction with a person that is part of, or operates for or on behalf of, the defense or intelligence sectors of the Government of the Russian Federation (the CAATSA Section 231 list);

US “Secondary” Sanctions

- Non-US Persons can be sanctioned if they:
 - Engage in significant activities undermining cybersecurity against any person, including a democratic institution or government, on behalf of the Russian Government;
 - Make a significant investment in a project intended to extract crude oil from: (1) the Exclusive Economic Zone of the Russian Federation in waters more than 500 feet deep; (2) Russian Arctic offshore locations; or (3) shale formations located in the Russian Federation;
 - Make a sizeable investment that contributes to the ability of the Russian Federation to privatize state-owned assets in a manner that “unjustly benefits” officials of the Government of the Russian Federation or their family members;

US “Secondary” Sanctions

- Non-US Persons can be sanctioned if they:
 - Make an investment that directly and significantly contributes to the enhancement of the ability of the Russian Federation to construct energy export pipelines;
 - Sell, lease, or provide to Russia goods, services, technology, information, or support that facilitates the maintenance or expansion of the construction, modernization, or repair of energy export pipelines; or
 - Violate, attempt to violate, conspire to violate, or cause a violation of any US sanction targeting Russia.

US “Secondary” Sanctions

- “Facilitates” – provides assistance
- “significant transaction” – totality of facts and circumstances
 - Factors considered:
 - Size, number and frequency
 - Nature
 - Level of awareness of management and pattern of conduct
 - Nexus between transaction and blocked person
 - Impact on statutory objectives
 - Deceptive practices involved
 - Attempts to obscure or conceal parties, true nature of deal, or evade sanctions
 - Any other relevant factors



Russia Counter-Sanctions

Patrick Brooks, Partner, Moscow

Sergey Treshchev, Partner, Moscow

Russian Counter-Sanctions Timeline

- **August 2014** Russia imposes restrictions on the import of various agricultural products sourced from the USA, EU, Canada, Australia, Norway, Ukraine and others.
- **April 2018** Rusal and others sanctioned
 - Bill proposed that would criminalize compliance with foreign sanctions.
- **4 June 2018** Federal Law 127 “On Actions to Influence (Counter) Unfriendly Actions of the United States of America and Other Foreign Governments” (the “**Counter-Sanctions Law**”) was passed authorizing implementation of sanctions by the President.
- **22 October 2018** Presidential Decree No 592 directing government to impose sanctions in response to unfriendly actions of Ukraine (the “**Sanctions Order**”) resulting in sanctions as of today against no less than:
 - 322 individuals, and
 - 68 legal entities.
- **2 April 2019** Resolution No. 400 passed providing disclosure exemptions.

- Effectively an implementing statute granting the President the power to impose sanctions of his choice.
- The President already had such powers under Federal Law 281 “On Special Economic Measures”.
- To be clear, the President has full authority under both laws to impose any sanctions, but several possible sanctions are enumerated, such as:
 - Termination or suspension of international cooperation
 - Import restrictions/bans
 - Export restrictions/bans
 - Restrictions/bans on participation in privatization of state property.
- Original bill included laundry list of potential sanctions that were walked back:
 - Loss of trademark protections
 - Employment bans
 - Professional service bans

Sanctions Order and Disclosure Exemption

- The implementing regulations provide for:
 - “blocking (freezing) electronic funds, undocumented securities, and property in the territory of the Russian Federation and a prohibition on transfers (withdrawal of capital) from the Russian Federation”
- Note that neither the Code of Administrative Offences nor the Criminal Code provide for penalties for breaches of the Counter-Sanctions Law or the Sanction Order at this time.
- The disclosure resolution amends companies and securities laws freeing certain persons from disclosure obligations related to such things as:
 - beneficial ownership, shareholders, affiliates, subsidiaries,
 - related-party transactions, shareholder disputes,
 - foreign currency transactions, counterparties **IF DISCLOSURE**
 - leads or may lead to the imposition of sanctions on the person;
 - the person is subject to sanctions;
 - the person is a state-owned bank;
 - disclosure is required in connection with a defense transaction/cooperation;
 - the persons, directors or employees are subject to sanctions.

Other Measures Taken

- **Expansion of Trade Embargo Against Ukraine**
 - Placed export ban on oil and licensing requirements placed on coal and fuel
 - Expanded import bans on numerous products (e.g. industrial pipe, machinery)
- **Localization**
 - Focus on pharmaceutical and payment service sectors
 - State procurement rules prefer and encourage local production
- **Capital Amnesty / Internal Offshore Zones**
- **Promsvyazbank**
 - Defense finance SPV
- **De-Dollarization Plan**
- **Law on Sovereign Internet**
 - Ensure uninterrupted internet access if hostile powers sought to block Russian access to the internet
 - Would require internet traffic to be routed through hubs controlled by Roskamnadzor



Anti-Corruption Trends

Kristina Arianina, Senior Associate, Washington DC

Anti-Corruption Developments in Russia

■ Anti-corruption laws

- Public and commercial bribery
- Russian and foreign government officials
- Federal Law No. 273-FZ
- Criminal Code
- Administrative Offences Code

■ Prosecution activity

- 2018
 - 7,800 corruption convictions
 - 439 convictions of legal entities
 - RUB 691 million in administrative fines against 439 entities
- 2019
 - High-profile investigations of public officials
 - 35 entities added to public register of Article 19.28 offenders

■ Public outreach

- **Article 13.3 of Anti-Corruption Law**
 - Appointment of a compliance officer
 - Cooperation with law enforcement authorities
 - Development and implementation of compliance policies and procedures
 - Adoption of a code of ethics
 - Prevention of conflicts of interest
 - Prevention of off-the-books record keeping and use of falsified documents
- **Article 2.1 of Administrative Code of Offenses**
 - “An entity shall be found guilty of committing an administrative offense if ... it had the opportunity to comply, but did not take all measures within its control to comply with such laws”
- **Article 4.2 of Administrative Code of Offenses**
 - Mitigating factors
 - Aggravating factors

Compliance in Russia (Cont.)

- **Why compliance matters**

- Prosecutions of legal entities are on the rise
- With the government's anti-corruption public outreach, further increase can be expected
- The law is clear: Art. 13.3 of Anti-Corruption Law, Art. 2.1 and 4.2 of Administrative Code of Offenses
- Prosecutors assess Art. 13.3 compliance when prosecuting for bribery
 - Mitigating factor
 - Possible defense
- Prosecutors conduct inspections to verify compliance with Art. 13.3
- Bribery offenders listing is highly damaging
 - State contracts
 - Other business relationships
 - Selling the company

Compliance Best Practices in the US

■ Government Guidance

- US Attorneys' Manual
- DOJ's guidance on the Evaluation of Corporate Compliance Programs
- Treasury's Framework for OFAC Compliance Commitments
- DOJ and SEC's Resource Guide to FCPA
- US Sentencing Guidelines

■ Best Practices

- Strong compliance function
- Timely and voluntary disclosure
- Willingness to cooperate
- Remedial actions, including efforts to implement or improve compliance program

■ Benefits under Government Guidelines

- Avoiding a full-blown government investigation
- Avoiding charges
- Negotiating plea or other agreements
- Getting a reduced sentence/fines

Hallmarks of an Effective Compliance Program

- Risk assessment
- Tone from the top
- Code of conduct and compliance policies and procedures
- Authority, autonomy, and resources
- Training and continuing advice
- Incentives and disciplinary measures
- Third-party due diligence
- Confidential reporting and internal investigations
- Periodic testing and review, continuous improvement
- Pre-acquisition due diligence and post-acquisition integration

Contacts



Kristina Arianina
Senior Associate
Washington DC
T +1 202 457 5139
E kristina.arianina@squirepb.com



Patrick Brooks
Partner
Moscow
T +7 495 258 52 50
E patrick.brooks@squirepb.com



Sergey Treshchev
Partner
Moscow
T +7 495 258 5250
E sergey.treshchev@squirepb.com



Dan Waltz
Partner
Washington DC
T +1 202 457 5651
E daniel.waltz@squirepb.com

Global Coverage

- | | | | |
|------------|-------------------|-----------------|---------------------------|
| Abu Dhabi | Houston | Santo Domingo | Africa |
| Atlanta | Leeds | Seoul | Brazil |
| Beijing | London | Shanghai | Caribbean/Central America |
| Berlin | Los Angeles | Singapore | India |
| Birmingham | Madrid | Sydney | Israel |
| Böblingen | Manchester | Tampa | Italy |
| Bratislava | Miami | Tokyo | Mexico |
| Brussels | Moscow | Warsaw | Turkey |
| Cincinnati | Newark | Washington DC | Ukraine |
| Cleveland | New York | West Palm Beach | |
| Columbus | Northern Virginia | | |
| Dallas | Palo Alto | | |
| Darwin | Paris | | |
| Denver | Perth | | |
| Doha | Phoenix | | |
| Dubai | Prague | | |
| Frankfurt | Riyadh | | |
| Hong Kong | San Francisco | | |

- Office locations
- Regional desks and strategic alliances

