Ukraine-Related Sanctions

Latest Developments Include U.S. Introduction of Sectoral Sanctions Imposing Targeted Sanctions on Certain Entities in Russia’s Financial Services and Energy Sectors; U.S. Designating Additional Persons and Entities as Blocked Persons; and New EU Designations Targeting Additional Individuals and Entities

SUMMARY

In response to the continued unstable situation in Ukraine, the European Union and the United States announced economic sanctions targeting certain Russian and Ukrainian persons and entities. The U.S. measures were taken prior to the date that Malaysia Airlines Flight 17 was shot down over Eastern Ukraine, reportedly by a Buk surface-to-air missile, and the EU announcements followed the occurrence of that incident. The U.S. measures include for the first time imposition of so-called “sectoral sanctions,” which at this time impose targeted sanctions against four Russian entities, two in the financial services sector and two in the energy sector. The United States and European Union added individuals and entities to the list-based sanctions previously imposed against a number of persons and entities in Russia and Ukraine, bringing the total of such listed parties to 249 in the United States and 107 in the European Union.

UNITED STATES

On July 16, the U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”) imposed a package of new sanctions on persons and entities in relation to the continuing instability in Ukraine. For the first time, the United States imposed “sectoral sanctions” on certain entities in Russia’s financial services and energy sector. As discussed in more detail below, the new sectoral sanctions prohibit U.S. persons from providing new medium- and long-term financing to two Russian financial institutions and two Russian energy firms. OFAC also designated as specially designated nationals and blocked persons, or
SDNs, eight Russian arms firms, three separatist groups, one entity that has been complicit in the misappropriation of Ukrainian state assets, and four Russian government officials, under the authority of prior Ukraine-related Executive Orders (“E.O.”) issued by President Obama.¹

**Sectoral Sanctions**

Notably, these actions are the first time that the U.S. Treasury Department has exercised the authority conferred under E.O. 13,662 to impose sanctions on persons in particular sectors of the Russian Federation economy.² The “sectoral sanctions,” at this time, are limited, targeting two sectors, but only four entities in those two sectors and only in a limited way designed to deny medium- and long-term funding to those entities. In the form of two “directives” – Directive 1 and Directive 2 – OFAC has imposed targeted sanctions on two major Russian financial institutions—Gazprombank OAO and VEB—and two energy firms—OAO Novatek and Rosneft. According to the U.S. Treasury’s announcement:

- **Gazprombank OAO** is a Russian financial institution that was originally established to provide financial services to companies in Russia’s energy industry, but has been expanded to provide services to more than 45,000 companies and 3 million private individuals. The financial institution has more than 40 branches across Russia, and a number of international subsidiaries.

- **VEB (or VNESHECONOMBANK)** is a Russian state-owned financial institution that acts as a development bank and payment agent for the Russian government. VEB’s supervisory board is chaired by the Russian prime minister, and the chairman of the bank is appointed by the Russian president. VEB acts as an agent for the Russian Government for the purposes of accounting, servicing, and repaying the sovereign debts of the former USSR and Russia; accounting, servicing, and repaying government loans issued by the former USSR and Russia to foreign borrowers; collecting debts from legal entities of Russia and municipal governments; providing and executing state guarantees of Russia; and monitoring projects implemented by Russia with the involvement of international financial institutions.

- **OAO Novatek** is Russia’s largest independent natural gas producer.

- **Rosneft** is Russia’s largest petroleum company and third largest gas producer. Treasury had previously designated Rosneft’s President and Chairman of the Board, Igor Sechin, on April 28, 2014, pursuant to E.O. 13,661.

These four entities are the inaugural entries on OFAC’s newly-published Sectoral Sanctions Identification List (“SSI List”).³ The SSI List identifies persons operating in sectors of the Russian economy identified by the Secretary of the Treasury pursuant to Executive Order 13,662. Directives 1 and 2 are stated within the SSI List and describe the applicable prohibitions.

The first directive (“Directive 1”) is applicable to Gazprombank OAO and VEB. The second directive (“Directive 2,” and, collectively with Directive 1, the “Directives”) applies to OAO Novatek and Rosneft. The Directives provide that absent an applicable exception or a license, the following transactions by any U.S. person⁴ (including any U.S. branch or agency of a non-U.S. bank) or within the United States are prohibited: (i) transacting in, providing financing for, or otherwise dealing in new debt⁵ (i.e., issued on or after July 16, 2014) of longer than 90 days maturity for Gazprombank OAO, VEB, OAO Novatek or Rosneft, their property or their interests in property and (ii) transacting in, providing financing for, or
otherwise dealing in new equity (i.e., issued on or after July 16, 2014) for Gazprombank OAO or VEB, their property or their interests in property. The prohibitions in the Directives extend to the rollover of existing debt, if such rollover results in the creation of new debt with a maturity of longer than 90 days. The prohibitions in the Directives extend to debt and/or equity, as applicable, issued for entities that are owned 50 percent or more by the entities specifically listed in the SSI List.

OFAC has not prohibited transactions with the entities listed in the Directives beyond what is specified in the Directives. OFAC did not require U.S. persons to block, or freeze, any property or interests in property of the four entities listed on the SSI List. Rather, U.S. financial institutions should decline to process, or reject, prohibited transactions or dealings with such persons. Any financial institution that rejects a prohibited funds transfer must report the rejection to OFAC within 10 business days.

Concurrently with the issuance of the Directives, OFAC issued General License No. 1 authorizing transactions involving derivative products whose value is linked to an underlying asset that constitutes debt with a maturity of longer than 90 days or equity issued on or after July 16, 2014 by an SSI Listed entity under Directive 1 or debt with a maturity of longer than 90 days issued on or after July 16, 2014 by an SSI Listed entity under Directive 2. This license does not authorize the holding, purchasing, or selling of underlying assets otherwise prohibited by the Directives.

U.S. firms should take reasonable, risk-based steps to ensure that they are not engaging in prohibited transactions, which should involve, at the least, increased due diligence when engaging in otherwise permissible transactions that the firm knows or suspects involve entities listed on the SSI List, or entities owned or controlled by such listed entities. OFAC recommends documenting the risk evaluation of any particular entity or transaction.

**Additional SDN Designations**

In addition, OFAC also designated numerous individuals and entities under the authority of Ukraine-related E.O. 13,660 and 13,661. Specifically, OFAC designated:

- eight Russian arms firms, said to be responsible for the production of a range of materiel that includes small arms, mortar shells, and tanks;
- the “Luhansk People’s Republic” and the “Donetsk People’s Republic,” separatist groups which have asserted governmental authority over parts of Ukraine without the authorization of the Government of Ukraine; and Aleksandr Borodai, the self-declared “prime minister” of the Donetsk People’s Republic, for threatening the peace, security, stability, sovereignty and territorial integrity of Ukraine;
- Feodosiya Enterprises, a key shipping facility in the Crimean peninsula, because it is complicit in the misappropriation of state assets of Ukraine; and
- four Russian government officials: Sergey Beseda, a senior Russian Federal Security Service official; Oleg Savelyev, Russia’s Minister for Crimean Affairs; Sergei Neverov, the Deputy Chairman of the State Duma of the Russian Federation; and Igor Shchegolev, an aide to the President of the Russian Federation.
Persons designated under OFAC’s Ukraine-related sanctions will be listed on the List of Specially Designated Nationals and Blocked Persons (the “SDN List”) with the tag [UKRAINE] or [UKRAINE2].

Absent an applicable exception or a license, it is unlawful for any U.S. person to do business with any designated person or entity, and any property that is in the United States or within the possession or control of a U.S. person in which any designated person or entity has an interest must be blocked, imposing an across-the-board prohibition against transfers or dealings of any kind with regard to such property. Substantial civil and criminal penalties may be applied for violations of these and other sanctions administered by OFAC.

Pursuant to OFAC guidance, if a designated person or entity owns, directly or indirectly, a 50 percent or greater interest in an entity, that 50 percent-owned entity also is considered blocked by OFAC, even if that entity has not been specifically designated by OFAC. U.S. persons are therefore prohibited from doing business with any entity in which a designated person or entity owns a 50 percent or greater interest. In other cases, such as where more than one designated person or entity has an ownership interest in an entity, and the combined ownership interests of the designated persons or entities in the entity equal 50 percent or more, or where a designated person or entity has a significant ownership interest in the entity that is less than 50 percent, or has management or other control of the entity, although the entity may not be considered per se blocked under OFAC guidance, U.S. persons should exercise caution in dealing with such entities for a variety of reasons, including that such entities may be designated by OFAC in the future.

OFAC guidance also imposes a burden on U.S. persons to assess whether they are dealing with an entity that is 50 percent or more owned by a designated person. As a general matter, U.S. persons should apply reasonable due diligence measures to all parties with which they are doing business in order to reduce the risk of dealing with a person or entity that is blocked pursuant to the OFAC guidance. For banks, OFAC has addressed the standard of care and due diligence that it expects in frequently asked question (“FAQ”) number 116, which states, in relevant part, that “OFAC expects banks to conduct due diligence on their own direct customers (including, for example, their ownership structure) to confirm that those customers are not persons whose property and interests in property are blocked.” OFAC further notes in the FAQ that, in instances where a wire transfer is passing through a U.S. bank that (1) is operating solely as an intermediary, (2) does not have any direct relationship with the entity (e.g., the entity is a non-account party), and (3) does not know or have reason to know the entity’s ownership or other information demonstrating the blocked status of the entity’s property, OFAC would not expect the bank to research the non-account parties listed in the wire transfer that do not appear on the SDN List and, accordingly, would not pursue an enforcement action against the bank for having processed such a wire transfer, even if the wire transfer was blocked under sanctions.
Additional guidance from OFAC staff has been provided with regard to individual persons who are SDNs. Members of OFAC staff have indicated that dealings with an individual person who is an SDN may be restricted even where that SDN is acting in a capacity other than his or her individual capacity (for example, if the individual SDN is acting as a corporate officer of an entity that is not itself an SDN, dealings with that individual in his corporate capacity may be restricted). U.S. persons should exercise caution in dealing with entities that may employ such SDNs or for which such SDNs may serve as officers or directors.

**EUROPEAN UNION**

On July 25, 2014, the European Council announced that an additional 15 individuals and 18 entities would be subject to sanctions. At the time of this announcement, there were only two entities sanctioned under the European Union’s Ukraine-related sanctions, and the new sanctions have aimed to increase the number of companies targeted, including companies of the Russian Federation “that are materially or financially supporting actions undermining or threatening Ukraine's sovereignty, territorial integrity and independence.” The European Council additionally agreed to expand the criteria for designation, which means that they will now be able to impose “asset freezes and visa bans on persons and entities that actively support or are benefitting from Russian decision makers responsible for the annexation of Crimea or the destabilisation of Eastern Ukraine.” Further, the European Council asked the European Investment Bank to suspend new investments in Russia, and will also seek a suspension of new lending by the European Bank for Reconstruction & Development.

The European Council has required the European Commission to consider, on a case-by-case basis, whether EU-Russian cooperation programs with Russia should be suspended, except those dealing with cross-border cooperation and security. The European Council also considered proposals by the European Commission and the European External Action Service on further targeted measures, to increase the impact of sanctions, focusing on “access to capital markets, defence, dual use goods, and sensitive technologies, including in the energy sector.” These proposals were considered at the Council’s meeting on July 24-25, 2014 and further decisions on the implementation on such measures are expected towards the end of July.

**NEXT STEPS**

In a July 16, 2014 statement, Treasury Secretary Jacob Lew stated "[w]e continue to coordinate with our international partners and remain in steadfast agreement that the people of Ukraine must be allowed to come together to make their own decisions about the future of their country, as Ukraine’s long-term stability is important for Europe, for Russia, and for the United States. Even as we continue to work with our partners to de-escalate the situation, we remain fully prepared to continue increasing the financial and economic pressure on Russia if it does not cease its provocative behavior.” In addition, although Treasury characterized the July 16, 2014 sanctions involving the financial and energy sector of Russia as
“targeted,” Treasury noted that it could expand the scope of the prohibited transaction types and the number of financial institutions and energy firms under the authority of E.O. 13662 if the Russian government does not take steps to de-escalate the situation in Ukraine.23

As noted above, the U.S. measures described herein were taken prior to the incident involving Malaysia Airlines Flight 17. Various legislators in the U.S. Congress have called on President Obama to escalate sanctions in light of that incident. Even if the incident does not itself lead to additional sanctions or an escalation in sanctions, additional U.S. measures are likely if the current situation continues to persist or escalate in Ukraine.

As noted above, leaders of the European Union have committed to announce additional measures by the end of July. The European Union and the United States have been reported to be in close diplomatic contact in connection with the situation in Ukraine, and that cooperation is expected to continue.

Clients interested in further information concerning these measures, including the scope of their application and manner of compliance therewith, are encouraged to contact the Sullivan & Cromwell lawyers identified at the end of this memorandum.

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These include E.O. 13,660 (March 6, 2014), E.O. 13,661 (March 17, 2014) and E.O. 13,662 (March 20, 2014).


“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.” E.O. 13,662 § 6(c).


The term “equity” includes stocks, share issuances, depository receipts, or any other evidence of title or ownership. See OFAC, FAQ 371.

See OFAC, FAQ 371.


Of course, if the SSI Listed entity were to become owned or controlled by a SDN, or otherwise listed as an SDN, blocking would be required. Blocking is not required solely because of the sectoral sanctions under Directive 1 and Directive 2.

See 31 C.F.R. § 501.604.


SDNs with the tag “[UKRAINE]” are associated with E.O. 13,660, while SDNs with the tag “[UKRAINE2]” are associated with E.O. 13,661. The SDN List is available at http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx. For additional information about these E.O.s and previous, related actions thereunder, see our Memorandum to Clients “U.S. and EU Adopt Economic Sanctions in Response to the Current Situation in Ukraine; Additional Measures Likely if Current Situation Persists or Escalates,” dated March 19, 2014, available at: http://www.sullcrom.com/ukraine-related-economic-sanctions.
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This generally means that U.S. persons are prohibited from providing funds, goods or services to or for the benefit of any designated person and from receiving any funds, goods or services from any designated person.

Criminal penalties for willful violations can include fines ranging up to $1 million and imprisonment of up to 20 years, while civil penalties can range up to $250,000 or twice the amount of the underlying transaction for each violation. See 50 U.S.C. § 1705.


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