

August 4, 2014

Ukraine-Related Sanctions

U.S. and EU Take Coordinated Action to Restrict Access of Russian State-Owned Banks to U.S. and EU Capital Markets, Restrict Trade with Russia, Including for Certain Deep Water, Arctic Offshore and Shale Exploration and Production Projects, and Sanction Additional Persons and Entities; U.S. Supplements Sectoral Sanctions Guidance

SUMMARY

The United States and the European Union announced additional economic sanctions to address events in eastern Ukraine and Russia's perceived continuing failure to take steps to stabilize the situation. These latest sanctions are reported to have been the result of close diplomatic contact between the United States and the European Union, and that cooperation is expected to continue.

UNITED STATES

Additional Parties Targeted by Sectoral Sanctions

For the second time in less than two weeks, the U.S. Treasury Department has exercised the authority conferred under Executive Order ("EO") 13,662¹ to impose "sectoral sanctions" on entities in the financial services sector of the Russian Federation economy in a way that is designed to deny medium- and long-term funding to these targets. On July 16, the U.S. Department of Treasury's Office of Foreign Assets Control ("OFAC") imposed targeted sanctions in the form of two "directives"—Directive 1, applicable to two major Russian financial institutions—Gazprombank OAO and VEB—and Directive 2, applicable to two energy firms—OAO Novatek and Rosneft. On July 29, OFAC imposed Directive 1 sanctions on three Russian state-owned financial institutions—VTB Bank OAO, Bank of Moscow and Russian Agricultural Bank (a.k.a. Rosselkhozbank). According to the U.S. Treasury's announcement:

- **VTB Bank OAO** is a state-owned bank, which, together with its subsidiaries (the "VTB Group"), is Russia's second-largest banking group. The VTB Group has more than 1,600 offices in Russia and

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operates more than 30 banks in 23 countries across Europe, Asia, and Africa. VTB Bank's shares are traded on the Moscow Exchange and the London Stock Exchange.

- **Bank of Moscow** is a Russian state-owned financial institution that is a subsidiary of VTB Bank OAO, which has 148 sub-offices located in all administrative districts of Moscow.
- **Russian Agricultural Bank (a.k.a. Rosselkhozbank)** is a state-owned bank, which acts as a Russian government agent offering a full range of financial services to clients. With a network of 78 regional branches and more than 1,500 additional offices covering Russia, it has the second-largest regional branch network in Russia.²

These three entities have been added to OFAC's Sectoral Sanctions Identification List ("SSI List").³

The prohibitions of Directive 1, which are described in our memorandum dated July 25,⁴ are now applicable to five Russian banks on the SSI List: Gazprombank OAO, VEB, VTB Bank OAO, Bank of Moscow and Russian Agricultural Bank. OFAC's actions do not prohibit transactions with these entities beyond what is specified in Directive 1 and applicable guidance. Further, U.S. persons are not required to block, or freeze, any property or interests in property of entities listed on the SSI List.⁵ 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.

Additional Guidance on Sectoral Sanctions

On July 28, OFAC issued updated Frequently Asked Questions ("FAQs") providing additional guidance regarding the sectoral sanctions,⁶ including:

- **Drawdowns on Pre-Existing Revolving Credit Facilities:** If a U.S. person has entered into a long-term credit facility or loan agreement prior to the effective date of the sanctions with regard to the SSI-listed party, drawdowns and disbursements whose repayment terms exceed 90 days are permitted if the terms of such drawdowns and disbursements, including the length of the repayment period, the interest rate applied to the drawdown and the maximum drawdown amount, were contractually agreed to prior to the effective date of the sanctions and are not modified on or after the effective date of the sanctions. (Drawdowns and disbursements with repayment terms of 90 days or less are permitted pursuant to the terms of Directive 1.) U.S. persons may not deal in a drawdown or disbursement initiated after the effective date of the sanctions with a repayment term of longer than 90 days if the terms of the drawdown or disbursement were negotiated on or after the effective date of sanctions.
- **Advising/Confirming Letters of Credit:** U.S. persons may advise or confirm a letter of credit issued on or after the effective date of the sanctions with regard to the SSI-listed party on behalf of a non-sanctioned entity in which an SSI entity is the beneficiary (i.e., the exporter or seller of the underlying goods) because the subject letter of credit does not represent an extension of credit to the SSI entity. U.S. persons, however, may not advise or confirm a letter of credit, because it would constitute an extension of credit to the SSI entity, if (1) the letter of credit was issued on or after the effective date of the sanctions, (2) the letter of credit carries a term of longer than 90 days maturity, and (3) an SSI-listed entity is the applicant of the letter of credit (i.e., the importer or buyer of the underlying goods).
- **New Depositary Receipts:** In order to determine whether U.S. persons may issue and deal in new depositary receipts that are based on equity issued by an SSI entity, reference must be made to the date that the SSI entity became subject to sectoral sanctions. U.S. persons may not deal in or issue depositary receipts that are based on equity issued by an SSI entity on or after the effective date of

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the sanctions, but generally may issue and deal in depository receipts that are based on equity issued by an SSI entity prior to the effective date of the sanctions.

- **Identification Problems When New Equity uses the same International Securities Identification Number (“ISIN”) or Other Identifier as Old Equity:** FAQ 392 identifies the problem of recognition of new equity when an issuer uses the same ISIN for equity issued prior to the effective date of the sanctions and equity issued following sanctions. However, no solution is provided – a U.S. person must ensure that, for any entity subject to Directive 1, it is not transacting in, providing financing for, or otherwise dealing in, the newly issued equity.
- **Derivative Transactions:** FAQ 393 clarifies that, in connection with derivatives transactions authorized pursuant to General License 1 to EO 13662, the associated normal counterparty credit risk does not constitute prohibited new debt.

SDN Designation

In addition, on July 29, OFAC designated as an SDN one Russian state-owned entity—United Shipbuilding Corporation—for operating in the arms or related materiel sector in Russia under the authority of Ukraine-related EO 13,661.⁷ United Shipbuilding Corporation is listed on the List of Specially Designated Nationals and Blocked Persons (the “SDN List”) with the tag [UKRAINE-EO13661].⁸ Absent an applicable exemption or license, it is unlawful for any U.S. person to do business with any SDN, 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 has an interest must be blocked, imposing an across-the-board prohibition against transfers or dealings of any kind with regard to such property.

Pursuant to OFAC guidance, if a designated person 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 owns a 50 percent or greater interest, regardless of whether such entity is listed on the SDN List.

Export Restrictions

On July 29, the U.S. Commerce Department’s Bureau of Industry and Security (“BIS”), which administers the Export Administration Regulations controlling the transfer of U.S.-origin “dual-use” goods and services (i.e., goods or services that have both civilian purposes and potential military applications), further restricted trade with Russia.⁹ BIS announced a policy of denying the export, reexport or foreign transfer of items for use in Russia’s energy sector that may be used for exploration or production from deep water, Arctic offshore or shale projects that have the potential to produce oil. BIS noted that the sanctions would not interfere with the current supply of energy from Russia or prevent Russian companies from selling oil and gas to any country, but would make it difficult for Russia to develop long-term, technically challenging future projects.¹⁰ In addition, BIS added United Shipbuilding Corporation—the same entity added by OFAC to its SDN List—to its Entity List.¹¹ Designations on the BIS Entity List impose a licensing requirement for the export, reexport or foreign transfer of items subject to the Export Administration Regulations to designated entities, with a presumption of denial.

EUROPEAN UNION

On July 31, the European Council issued measures targeting Russian state-owned banks, specifically Sberbank (which is not targeted by the United States under Directive 1), VTB Bank (a.k.a. VTB Bank OAO), Gazprombank, Vnesheconombank (a.k.a. VEB) and Rosselkhozbank (a.k.a. Russian Agricultural Bank) and their subsidiaries established outside the European Union. These measures also target entities acting on behalf of, or at the direction of, the targeted banks and their non-EU subsidiaries. European Union nationals and companies are prohibited from directly or indirectly “purchas[ing], sell[ing], provid[ing] brokering or assistance in the issuance of, or otherwise deal[ing] with transferable securities and money-market instruments with a maturity exceeding 90 days, issued after 1 August 2014” of the targeted entities. Unlike the U.S. measures targeting dealings in all equity and debt (defined broadly), the EU measures target dealings in “transferable securities,” defined as those classes of securities which are negotiable on the capital market, with the exception of instruments of payment (such as shares in companies and equivalents, depositary receipts, bonds or other forms of securitized debt, and any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement) and “money-market instruments,” defined as those classes of instruments which are normally dealt in on the money market, such as treasury bills, certificates of deposit and commercial papers and excluding instruments of payment.¹²

The EU measures also increased restrictions on imports from and exports to Russia. The European Council agreed to an embargo on the import and export of arms and related materiel to and from Russia, with exceptions for existing contracts.¹³ The embargo covers all items on European Union’s common munitions list.¹⁴ There is also a restriction on the export of dual-use goods and technology for military use or to Russian military end users.¹⁵ Finally, exports of certain energy-related equipment and technology to Russia are subject to prior authorization by EU member states and, similar to the U.S. measures, will be denied if the products are destined for deep water oil exploration or production, Arctic oil exploration or production and shale oil projects in Russia.

In addition, on July 30, the European Council imposed sanctions¹⁶ on eight individuals and three entities. This brings the number of persons and entities under the EU sanctions to 95 persons and 23 entities. These designations were made pursuant to a July 25 expansion of the criteria for designation, which allowed the European Union to impose “asset freezes and visa bans on persons and entities that actively support or are benefiting from Russian decision makers responsible for the annexation of Crimea or the destabilisation of Eastern Ukraine.”¹⁷ Further, on July 25, 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.

Finally, the new EU measures imposed bans on certain new investments in specified areas of eastern Ukraine. On July 30, the European Council imposed a ban on new investment in Crimea and Sevastopol,

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taking effect from July 31, in the following sectors: “infrastructure projects in the transport, telecommunications and energy sectors and in relation to the exploitation of oil, gas and minerals.”¹⁸ The ban includes a prohibition on key equipment for these sectors as well as the provision of finance and insurance services to banned transactions.

NEXT STEPS

In a July 29 statement, U.S. Treasury Secretary Jacob Lew stated “[w]e have seen sanctions bring the Russian economy to a standstill through a large and broad-based deterioration of Russian financial assets; capital flight that already exceeds all of last year; and a significant increase in Russian borrowing costs. These actions are designed to demonstrate the unity of the international community and the increasing isolation of Russia. We are prepared to take additional actions if Russia does not take steps to resolve this crisis.”¹⁹

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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ENDNOTES

- ¹ For more information on EO 13,662 and actions taken by OFAC pursuant to its authority thereunder, see our Memorandum to Clients entitled “U.S. and EU Expand the List of Parties Targeted by Economic Sanctions in Response to Evolving Ukraine Crisis and Russia’s Failure to Meet Geneva Commitments; New Measures Target Certain Russian Officials and Persons Close to President Putin, Including Several Russian Entities; Package of Sanctions Now Includes Expanded List of Blocked Persons, Travel and Visa Bans and Export Denials,” dated May 2, 2014, available at: <http://www.sullcrom.com/ukraine-related-sanctions>. For additional background on Ukraine-related sanctions administered by OFAC, see our Memorandum to Clients entitled “Ukraine-Related Economic Sanctions: 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>. EO 13,662 is available at: <http://www.treasury.gov/resource-center/sanctions/Programs/Pages/ukraine.aspx>.
- ² U.S. Department of the Treasury, Press Release (July 29, 2014), “Announcement of Additional Treasury Sanctions on Russian Financial Institutions and on a Defense Technology Entity,” available at: <http://www.treasury.gov/press-center/press-releases/Pages/jl2590.aspx>.
- ³ The SSI List is available at: <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20140716.aspx>.
- ⁴ 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, dated July 25, 2014, available at: <http://www.sullcrom.com/ukraine-related-sanctions-latest-developments-include-us-introduction-of-sectoral-sanctions-imposing-targeted-sanctions-on-certain-entities>.
- ⁵ Blocking is not required solely because of the sectoral sanctions under Directive 1. 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.
- ⁶ See OFAC, “Publication of Updated Frequently Asked Questions Regarding Ukraine-Related Sanctions,” available at: <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20140728.aspx>.
- ⁷ EO 13,661 and other information regarding Ukraine-related sanctions administered by OFAC are available at: <http://www.treasury.gov/resource-center/sanctions/Programs/Pages/ukraine.aspx>. According to the U.S. Treasury’s announcement, United Shipbuilding Corporation is a Russian state-owned company that designs and constructs ships for the Russian Navy and manufactures ordnance and accessories.
- ⁸ The SDN List is available at: <http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx>. On July 31, OFAC changed the tags of SDNs designated under the authority of EO 13,660 and EO 13,661 to [UKRAINE-EO13660] and [UKRAINE-EO13661], respectively. Previously, SDNs designated under EO 13,660 and EO 13,661 were tagged on the SDN List as [UKRAINE1] and [UKRAINE2], respectively.
- ⁹ For information on BIS’ previous actions in relation to restrictions on exports from the United States to Russia and Russia-occupied Crimea, see our Memorandum to Clients dated May 2, 2014, *supra* note 1.
- ¹⁰ BIS, Press Release (July 29, 2014), “U.S. Commerce Department Expands Export Restrictions on Russia,” available at: <http://www.bis.doc.gov/index.php/about-bis/newsroom/press-releases/107-about-bis/newsroom/press-releases/press-release-2014/710-u-s-commerce-department-expands-export-restrictions-on-russia>.

ENDNOTES (CONTINUED)

- ¹¹ The Entity List is available at: <http://www.bis.doc.gov/index.php/policy-guidance/lists-of-parties-of-concern/entity-list>.
- ¹² European Union Regulation 833/2014 (July 31, 2014), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:JOL_2014_229_R_0001.
- ¹³ *Id.* See also Council of the European Union, Press Release (July 29, 2014), “EU restrictive measures in view of the situation in Eastern Ukraine and the illegal annexation of Crimea,” available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/144159.pdf.
- ¹⁴ The common munitions list is available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014XG0409%2801%29&from=EN>. The embargo is imposed by European Union Regulation 833/2014, Article 4(1)(a).
- ¹⁵ See European Union Regulation 833/2014, Article 4(1)(b).
- ¹⁶ European Union Regulation 826/2014 (July 30, 2014), available at: http://eur-lex.europa.eu/legal-content/EN/TXT;ELX_SESSIONID=LxdKThhRhytC3nMwW4cgXLklHhv649zsZcYvwpp0hTgfRrs6Ly0y!-1089773297?uri=OJ:JOL_2014_226_R_0003.
- ¹⁷ Council of the European Union, Press Release (July 25, 2014), “EU sanctions over situation in Eastern Ukraine strengthened,” available at: http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/144144.pdf.
- ¹⁸ European Union Regulation 825/2014 (July 30, 2014), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:JOL_2014_226_R_0002. See also Council of the European Union, Press Release, *supra* note 13.
- ¹⁹ Statement of Treasury Secretary Jacob J. Lew (July 29, 2014), available at: <http://www.treasury.gov/press-center/press-releases/Pages/jl2591.aspx>.

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