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ALERT MEMORANDUM

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Ukraine-related Sanctions: Expanded U.S. Sanctions Against Russian Financial, Energy, and Defense Sectors

On September 12, 2014, the United States imposed additional sectoral sanctions on the Russian financial, energy, and defense sectors, resulting in a relatively modest expansion of previous financial sanctions and a significant tightening of controls on the provision of goods and services in support of targeted Russian oil projects. This memorandum provides further detail on these developments.

Overview

- The United States tightened restrictions on new debt issued by listed Russian financial institutions, reducing the allowable maturity from 90 days to 30 days. Equity sanctions were unchanged.
  - o Sberbank was added to the list of sanctioned financial institutions (Bank of Moscow, VEB, VTB, Gazprombank, and Russian Agricultural Bank).
- Restrictions on new debt issued by listed Russian energy companies were not changed, nor were equity restrictions added.
  - o Transneft and Gazprom Neft were added to the list of sanctioned energy companies for these purposes (Novatek and Rosneft).
- Sectoral sanctions were created for the Russian defense sector, prohibiting new debt transactions with a maturity of greater than 30 days.
  - o Only one entity, Rostec, was listed.
- Sanctions against Russian deepwater, Arctic offshore, or shale projects that have the potential to produce oil were also tightened to prohibit the provision of technical assistance or other services (except financial services) or U.S.-origin goods of any kind to specified companies for these projects. Similar sanctions prohibiting the export, re-export, or transfer of U.S.-origin goods or technology to the targeted firms for these uses were added by the Department of Commerce.
  - o Gazprom, Gazprom Neft, Lukoil, Rosneft, and Surgutneftegaz were named to this new list.

- Five Russian defense firms were identified as SDNs pursuant to Executive Order 13661, and as a result all transactions with these entities involving U.S. persons, U.S. dollar transactions clearing through the United States, or other elements within U.S. jurisdiction are now prohibited. Simultaneously, the Department of Commerce added these entities to the Entity List, prohibiting the export, re-export, or transfer of U.S.-origin goods or technology of any kind to the companies.
    - The newly listed firms are Almaz-Antey Air Defense Concern Main System Design Bureau Named by Academician A.A. Raspletin, V. Tikhomirov Scientific Research Institute of Instrument Design, Kalinin Machine Plant, Mytishchinski Mashinostroitelny Zavod, and Dolgoprudny Research Production Enterprise.

Treasury Department Sanctions

Expansion of Sectoral Sanctions:

As detailed in Cleary Gottlieb's alert memorandum of July 17, 2014, on July 16, 2014, U.S. Treasury Secretary Lew issued two Directives pursuant to Executive Order 13662, identifying the Russian financial and energy sectors for sanctions pursuant to the Executive Order. Transactions within U.S. jurisdiction involving new debt of sanctioned Russian financial institutions with a maturity of greater than 90 days or new equity of those institutions were prohibited; for the sanctioned Russian energy companies, only transactions in debt with a maturity of greater than 90 days were prohibited. These prohibitions extended to any activity within U.S. jurisdiction, including not only transactions by U.S. persons or persons within the United States but also supporting services provided by such persons (most notably U.S. dollar clearing, which is necessary to virtually all international transactions conducted in dollars).

The Directives did not sanction all Russian companies in the targeted sectors; rather, they provided the Office of Foreign Assets Control ("OFAC") with the authority to designate particular entities for sanctions. These entities are listed on OFAC's Sectoral Sanctions Identifications List ("SSI List").

On September 12, 2014, Secretary Lew amended Directives 1 and 2 and, pursuant to Executive Order 13662, issued two additional Directives, Directive 3 and Directive 4, which target the defense and energy sectors, respectively. The Treasury Department also designated entities subject to Directives 3 and 4 and designated new entities for Sectoral Sanctions pursuant to Directives 1 and 2.

Directive 1, which targets the financial sector, was amended to cut the allowable maturity of debt instruments issues by, on behalf of, or for the benefit of persons subject to Directive 1 from 90 days to 30 days. The amended version of Directive 1 prohibits "all transactions in, provision of financing for, and other dealings in new debt of longer than 30 days maturity or new equity of persons [designated within the Russian financial sector], their property, or their interests in property" effective September 12, 2014. As a result, no new U.S. dollar debt of longer than 30 days or equity transaction financing these entities are permissible, and U.S. institutions, investors, and advisors cannot participate in, or provide services in support of, such transactions in any currency.[1] Restrictions on trading in new equity of these entities remain unchanged.

All transactions that were prohibited under the prior version of Directive 1, issued on July 16, 2014, remain impermissible. This means that trading in debt issued on or after July 16, 2014, with a maturity of longer than 90 days by entities in Russia's financial sector named on the SSI List on July 16, 2014, or equity issued by those entities, remains prohibited; however, trading in debt with a maturity of longer than 30 days issued by those entities prior to September 12, 2014, is permissible except to the extent that it is prohibited by the prior version of Directive 1. Sberbank was also designated under Directive 1, joining the previously designated Bank of Moscow, Gazprombank, Russian Agricultural Bank, Vnesheconombank (VEB), and VTB.

Directive 2, which targets the energy sector, was not changed in scope; it continues to target only transactions involving new debt with a maturity of greater than 90 days. However, Gazprom Neft and Transneft were designated for sanctions, joining Novatek and Rosneft.

Directive 3, targets the Russian defense sector and prohibits "all transactions in, provision of financing for, and other dealings in new debt of longer than 30 days maturity of persons [designated within the Russian defense sector], their property, or their interests in property." The restrictions on new debt thus parallel those applicable to Russian financial institutions. Rostec was the only company designated under Directive 3.

Directive 4 also targets the Russian energy sector and prohibits "the provision, exportation, or reexportation, directly or indirectly, of goods, services (except for financial services, including U.S. dollar clearing and insurance contracts), or technology in support of exploration or production for deepwater [greater than 500 feet], Arctic offshore, or shale projects that have the potential to produce oil in the Russian Federation, or in the maritime area claimed by the Russian Federation and extending from its territory" for designated companies. Unlike the comparable (and newly expanded) BIS restrictions on exports in support of oil projects (discussed below), Directive 4 covers services as well as goods and technology, such as drilling,

[1] OFAC guidance released on July 16, 2014 and reissued on September 12, 2014, defines debt and equity broadly as follows: "The term debt includes bonds, loans, extensions of credit, loan guarantees, letters of credit, drafts, bankers acceptances, discount notes or bills, or commercial paper. The term equity includes stocks, share issuances, depositary receipts, or any other evidence of title or ownership."

geophysical, geological, logistical, or management services, modeling, or mapping, excluding only financial services such as clearing transactions or insurance (but not extensions of credit prohibited under Directive 2). Projects with the potential to produce both oil and gas are restricted, but gas projects with no potential to produce oil are not. Gazprom, Gazprom Neft, Lukoil, Rosneft, and Surgutneftegaz were designated under Directive 4.

As before, entities designated for inclusion in the SSI List under any of the Directives are not SDNs subject to comprehensive restrictions on all transactions within U.S. jurisdiction, and the Treasury Department has indicated that it "has not blocked the property or interests in property of these companies, nor prohibited transactions with them beyond these specific restrictions." Other than with respect to the specific transactions set forth above, transactions with these entities by U.S. persons or in U.S. dollars may proceed as usual.

Clarifications and Interpretations:

All four Directives now contain language, standard in other OFAC sanctions programs, stating that the restrictions prohibit transactions that evade or avoid, have the purpose of evading or avoiding, cause a violation of, or attempt to violate any directive, as well as conspiracies to violate the directive. This confirms prior informal guidance and is consistent with OFAC's general approach across the sanctions programs it administers. OFAC has also issued, and continues to update, a number of "frequently asked questions" regarding the sectoral sanctions. One particularly important interpretation is that payment terms in excess of the specified maturities are considered prohibited debt, even if no interest is charged.

As detailed in our alert memorandum of August 14, 2014, pursuant to recently issued guidance on entities owned by blocked persons, entities owned 50% or more in the aggregate by one or more entities named on the SSI List are sanctioned as a matter of law and subject to the same restrictions as the named parent entities.

General Licenses:

Finally, OFAC has now issued two general licenses under its Ukraine-related sanctions regime. General License 1A supersedes General License 1, issued July 16, 2014, and authorizes transactions "involving derivative products whose value is linked to an underlying asset" restricted by Directives 1, 2, or 3. This authorization is substantially the same as the predecessor General License 1, and no further clarification of the scope of the license was provided.

General License No. 2 permits activities "ordinarily incident and necessary to" winding down operations and contracts newly prohibited by Directive 4 that were in effect before September 12, 2014. Parties have two weeks (until September 26) to complete the winding down process. U.S. persons must file a report with OFAC's Licensing Division within ten days after completing any wind-down transactions, detailing exactly what was done in reliance upon the license. General License No. 2 does not authorize the provision, exportation, or re-exportation of new goods, services, or technology after the effective date beyond those necessary to cease operations now prohibited by Directive 4.

Designation of Additional SDNs:

Separately, on September 12, 2014, the Treasury Department also designated five more Russian defense firms as SDNs pursuant to Executive Order 13661, which authorizes sanctions against persons and entities operating within the Russian arms sector. As a result, all transactions with these entities involving U.S. persons, U.S. dollar clearing, or other actions within U.S. jurisdiction are now prohibited.

The following firms were designated as SDNs under Executive Order 13661:

- Almaz-Antey Air Defense Concern Main System Design Bureau Named by Academician A.A. Raspletin
- V. Tikhomirov Scientific Research Institute of Instrument Design
- Kalinin Machine Plant
- Mytishchinski Mashinostroitelny Zavod
- Dolgoprudny Research Production Enterprise.

Department of Commerce Restrictions

August 1 Rule:

The U.S. Department of Commerce's Bureau of Industry and Security ("BIS") adopted a rule on August 1, 2014 (effective August 6), that imposed new export controls on exports of oil and gas exploration equipment to Russia.[2] The rule imposed "Russian Industry Sector Sanctions," which restrict (1) exports, re-exports, and transfers of items subject to the Export Administration Regulations ("EAR") (2) meeting certain specifications (3) for use in certain oil and gas production activities in Russia. In brief, the rule prohibits all persons worldwide from supplying U.S.-origin oil and gas exploration equipment for use in Russian deepwater drilling, Arctic offshore, or shale oil

[2] 79 Fed. Reg. 45675 (Aug. 6, 2014).

and gas projects without a license from the United States. We examine each element in turn.

Exports, re-exports, and transfers of items subject to the EAR

Essentially, this element states that the new rules apply to the supply of any U.S.-origin goods. An item is "subject to the EAR" if it is either produced in the United States or physically located in the United States. The U.S. export control rules apply whether a U.S.-origin item is transferred from the United States to another country (export), from one foreign country to another (re-export), or between parties within a foreign country (transfer), regardless of who the parties to the transaction are and whether they have any presence in the United States. Unlike OFAC's rules, EAR jurisdiction is based on the origin of the item and persists even if the U.S.-origin goods are transferred outside the United States and the supplier is a non-U.S. person with no other connection to the United States – the U.S. origin of the goods alone is sufficient to trigger the application of U.S. export control law. Also, U.S. export and re-export controls are triggered by the physical transfer of goods from one country to another, even if there is no sale of the goods (for example, a U.S. oil services company transporting its own equipment to Russia).

Specified equipment

The August 1 rule targeted a broad range of goods (not limited to "dual-use" goods and technologies, as is normally the case with export controls) including, but not limited to, drilling rigs, parts for horizontal drilling, drilling and completion equipment, subsea processing equipment, Arctic-capable marine equipment, wireline and down hole motors and equipment, drill pipe and casing, software for hydraulic fracturing, high pressure pumps, seismic acquisition equipment, remotely operated vehicles, compressors, expanders, valves, and risers, as well as software and data related to oil and gas exploration.

Use in specified oil and gas activities

No person may supply the specified U.S.-origin items for use directly or indirectly in Russia's energy sector for exploration or production that has the potential of producing oil or gas from (1) deepwater (greater than 500 feet), (2) Arctic offshore, or (3) shale projects in Russia. Supply is prohibited if the supplier either knows or is informed that the items will be so used or is unable to determine whether the items will be so used; in practice, this creates an obligation on the supplier to affirmatively establish that the restricted equipment will not be used in any of the specified projects.

Licensing

Controlled goods may still be exported or re-exported to Russia with a license from BIS. However, BIS has stated that it presumptively will deny any application "when for use directly or indirectly for exploration or production from deepwater (greater than 500 feet), Arctic offshore, or shale projects in Russia that have the potential to produce oil." Although export controls do apply to U.S.-origin items to be used in deepwater, Arctic offshore, and shale projects to produce gas, the statement of licensing policy does not appear to cover gas-only projects. Thus, while a license is needed to supply U.S.-origin equipment to the specified gas development applications, it seems that BIS may grant such licenses on a case-by-case basis. BIS has not further elaborated its policy to date.

September 12 Expansion:

BIS has issued a press release stating that it intends to further tighten export controls on Russian gas projects by adding five firms to the BIS "Entity List": Gazprom, Gazprom Neft, Lukoil, Rosneft, and Surgutneftegaz (the same entities designated under Directive 4). This designation will require a U.S. license for the export, re-export, or transfer of <u>any</u> U.S.-origin goods or technology (not only the drilling equipment described above) if the exporter, re-exporter, or transferor "knows those items will be used directly or indirectly in exploration for, or production from, deepwater, Arctic offshore, or shale projects in Russia." The license presumptively will be denied if the project in question has the potential to produce oil.

BIS also announced that the five defense firms named as SDNs were being added to the Entity List, requiring a license for the export, re-export, or transfer of any goods or technology subject to the EAR and establishing a policy of presumptive denial.

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Please feel free to raise any question you may have with any of your regular contacts at the Firm, or with [Paul Marquardt] in our Washington office.

Appendix

Ukraine-Related Executive Orders

Executive Order 13660 (March 6, 2014)
http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo.pdf

Executive Order 13661 (March 16, 2014)
http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo2.pdf

Executive Order 13662 (March 20, 2014)
http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo3.pdf

Sectoral Sanctions

Directive 1 (Amended) under Executive Order 13662
http://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13662_directive1.pdf

Directive 2 (Amended) under Executive Order 13662
http://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13662_directive2.pdf

Directive 3 under Executive Order 13662
http://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13662_directive3.pdf

Directive 4 under Executive Order 13362
http://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13662_directive4.pdf

Sectoral Sanctions Identification List
http://www.treasury.gov/ofac/downloads/ssi/ssi.pdf

Sectoral Sanctions General License 1A
http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_gl1a.pdf

Sectoral Sanctions General License 2
http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_gl2.pdf

Sectoral Sanctions Frequently Asked Questions
http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answers2.aspx#sectoral

Press Release of September 12, 2014
http://www.treasury.gov/press-center/press-releases/Pages/jl2629.aspx

Department of Commerce

Russian Oil Industry Sanctions and Addition of Person to the Entity List (August 1, 2014)
http://www.bis.doc.gov/index.php/regulations/federal-register-notices#79fr45675

Press Release of September 12, 2014
http://www.bis.doc.gov/index.php/about-bis/newsroom/press-releases/107-about-bis/newsroom/press-releases/press-release-2014/742-u-s-commerce-department-expands-export-restrictions-aimed-at-russia-s-defense-sector

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