

US and EU Economic Sanctions

What you need to know for your business

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Presenter



Anita Esslinger

Agenda

- General overview of US and EU Sanctions
- US unilateral sanctions – Cuba
- US Iran sanctions
- EU Iran sanctions
- Ukraine/Russia sanctions – US and EU
- Sanctions and Banks
- Compliance issues

Why is this important?

- Violations can result in serious criminal and civil penalties – as well as denial of export privileges – and can have serious reputational consequences
- Successor liability in M&A transactions, even asset acquisitions
- Disruptive effects of investigations
- Sanctions can prevent or hinder business, make it difficult or impossible to obtain financing and to make and receive payments

Economic Sanctions

- Foreign policy and national security objectives
- Scope of sanctions depends on each program
 - Some are comprehensive
 - Others targeted or limited in scope

Whose Rules are Relevant?

- Compliance systems often need to deal with multiple regimes
 - Particularly those of the United States
 - ◆ Extraterritorial effect
 - ◆ Aggressive enforcement, including against non-US companies

UN Security Council Sanctions

- Must be implemented by UN members – not self-executing
- “Smart” sanctions – arms embargoes, asset freezes and travel bans targeted at specific actors, some humanitarian exceptions
- Sometimes difficult to get consensus

US Sanctions

- The US cooperates in multilateral sanctions, such as UN and some EU sanctions, but often goes beyond
- Very complex and differ for different sanctioned countries and persons
- OFAC maintains a list of Specially Designated Nationals and Blocked Persons (“SDN”) List – thousands of names designated under various sanctions regimes – asset freezing and dealing prohibitions

50% Rule

- OFAC Guidance treats entities owned 50% or more by one or more persons on the SDN List, on an aggregate basis, also to be blocked even though not listed
- This is a change in policy, which until recently did not aggregate the interests of SDNs
- The 50% rule applies to ownership, not control, but beware ...

Application to US Persons

- US economic sanctions affect US persons:
 - US citizens and green card holders, wherever located
 - US entities and their branches, wherever located
 - Any person in the US
- For Cuba and Iran sanctions, US restrictions also apply to foreign entities owned or controlled by US persons

Non-US Persons

- However, even where US economic sanctions do not extend the prohibitions on US persons to their non-US affiliates, US sanctions can affect both affiliated and non-affiliated non-US persons:
 - In respect of actions involving US-origin items when those items are subject to US export controls
 - US dollar transactions or US banks
 - Causing, aiding and abetting US violations – broad interpretation

Non-US Persons

- US persons may not facilitate a transaction by a non-US person that the US person would be prohibited from engaging in
- Referral of orders to which a US person (or its owned or controlled affiliate) could not respond
- Assistance or support of trading activity or financial transactions (but not activity of a purely clerical or reporting nature that does not further such transactions)
- Permissible legal compliance counselling versus facilitation?
 - Calling “balls and strikes” versus structure advice?

EU Sanctions

- For EU-wide sanctions, a Common Position must be adopted which requires the unanimous consent of all the member states
- Within the framework of the EU's Common Foreign & Security Policy, the Council of the EU may impose sanctions against countries, entities or individuals
- Some sanctions are implemented directly by the member states, such as arms embargoes and visa bans

EU Sanctions

- Council Decisions on freezing of funds and economic resources or other trade restrictions are implemented by means of Regulations, binding and directly applicable in all the member states, and administered and enforced by the competent authorities in the relevant member states
- They are subject to judicial review and must take into account fundamental human rights
- Council Decisions may have a review or an expiration date
- The EU generally favours targeted or “smart” sanctions rather than total embargoes

EU Freezing Sanctions – Ownership/Control

- No 50% rule as in the US for freezing purposes
- However, Guidelines issued by the Council state that making funds or economic resources available to a non-listed person that is owned or controlled by a designated person will in principle be considered as making them indirectly available to the designated person unless it can reasonably be determined they will not be used by or for the benefit of the designated person
- Ownership is more than 50%, but control is also an issue and the guidelines provide examples of control

EU Sanctions

- Provisions prohibiting circumvention of the prohibitions in the EU sanctions
- EU defense if a person did not know and did not have reasonable cause to suspect their actions would infringe the sanctions – differs from normal US strict liability
- Often grandfather provisions, unlike most US sanctions

To Whom Do EU Sanctions Apply?

- Within the EU, including its airspace
- On board any aircraft or vessel under the jurisdiction of a member state
- To any person inside or outside the EU who is a national of a member state
- To any legal person, entity or body inside or outside the EU, which is incorporated or constituted under the laws of a member state
- To any legal person, entity or body in respect of any business done in whole or in part in the EU

US Unilateral Sanctions – Cuba

- The Cuban Assets Control Regulations (CACR) prohibit without a licence all dealings by any person subject to US jurisdiction in any property in which Cuba or a Cuban national has an interest of any nature whatsoever
- Very broadly interpreted – virtually a complete embargo on dealings with Cuba and Cuban nationals
- Applies to non-US affiliates of US persons

Cuba – Blocking Legislation

- Several jurisdictions, including Canada, Mexico and the EU have passed blocking legislation
- Council Regulation (EC) No 2271/96
 - Requires reporting; prohibits compliance; judgments not enforced – US denial lists?
 - European companies and directors and US parents between a rock and a hard place
 - Risk assessment

US Sanctions Affecting Iran

- Multiple legal authorities
- Iranian Transactions and Sanctions Regulations (ITSR)
- Anti-terrorism sanctions
- Non-proliferation sanctions
- Human rights
- Secondary sanctions affecting non-US persons who engage in certain transactions with Iran – ISA, CISADA, NDAA and various orders

ITSR

- Comprehensive trade embargo affecting exports, imports, investments
- Affects primarily US persons and now Non-US affiliates of US persons
- But also affects other non-US persons in respect of transactions involving US-origin items
 - Reexports of controlled items by non-US persons
 - Overlap with normal export controls
 - Causing violations by US persons

ITSR

- Prohibit export, reexport, sale, or supply goods, technology or services without a license from the US or by a US person or its affiliates anywhere:
 - to Iran or the Government of Iran, or
 - to persons in 3rd countries with knowledge or reason to know intended specifically for Iran or the Government of Iran or for use in the production of, for commingling with or incorporation into items exclusively or predominantly for Iran or the Government of Iran

ITSR

- Regardless of the origin of the goods or whether or not they are controlled under normal export controls
- General License available for certain non-controlled agricultural products, medicine, medical devices and medical supplies
 - Strict requirements relating to payments and customers (no military or law enforcement)

ITSR

- Other prohibitions on US persons and their affiliates:
 - Investments
 - Transactions with respect to the development of Iranian petroleum resources
 - Dealings in property of the Government of Iran, the Central Bank of Iran, and of any Iranian financial institution and persons designated on the SDN list

ITSR

- Other prohibitions:
 - Transactions or dealings by US persons or their affiliates (including facilitation or approval) in or related to goods or services of Iranian origin or owned or controlled by the Government of Iran, or goods, technology or services for supply to Iran or the Government of Iran
 - Evasion, attempts and conspiracy to evade US sanctions

Foreign Sanctions Evaders Order

- Transactions by US persons with non-US persons identified as causing violations of Iran or Syrian sanctions may be prohibited – including exporting, reexporting, importing, selling, purchasing
 - Effectively cutting the identified person off from the US market place

Secondary Sanctions

- Iran Sanctions Act of 1996 (ISA), Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA), and others authorize or mandate the President to impose a variety of sanctions on non-US persons, that engage in certain activities in respect of Iran

EU Iran Sanctions

- Requires freezing of funds and economic resources belonging to, owned, held or controlled by sanctions targets – including many banks
- Prohibits making funds or economic resources (including goods, regardless of origin or whether they are controlled under normal export controls) available to or for the benefit of sanctions targets

EU Iran Sanctions

- In addition to freezing sanctions, prohibit the sale, supply, transfer or export, directly or indirectly of certain goods or technology, regardless of origin, to any Iranian person, entity or body or for use in Iran

EU Iran Sanctions

- Iranian person, entity or body
 - the State of Iran or any public authority thereof
 - any natural person resident in Iran
 - any legal person, entity or body with its registered office in Iran
 - any legal person, inside or outside Iran, owned or controlled by one or more of the above
- Difficult due diligence issues

EU Iran Sanctions

- Sanctions targets include most major Iranian banks
- Restrictions on transfers of funds to and from Iranian persons, entities or bodies (whether in or outside Iran)
- Generally require freezing of funds that come into an EU member state where a sanctioned bank is anywhere in the chain of payment

Effect of Iran Negotiations

- 23 November 2013, the UK, US, Germany, France and Russia announced “initial understandings” to relax sanctions in exchange for limits on Iran’s nuclear program extended to 24 November 2014 if Iran abides by its commitments
 - US relaxation basically limited to possible licensing of certain airline safety related repairs and relaxation of secondary sanctions on non-US persons who are not affiliates of US companies
- Most restrictions still in place for US persons and their affiliates

Summary of US Russia/Ukraine Sanctions

- Freezing of assets of persons on the SDN List – 50% rule
- Sectoral sanctions against financial, energy and defense companies on Sectoral Sanctions Identifications (“SSI”) List – 50% rule
- Export control driven sanctions in the Export Administration Regulations and for persons on the Entity List

US Freezing Sanctions – Russia/Ukraine

- US persons (not including non-US affiliates) are required to block assets of and prohibited from dealing with persons and entities on the SDN List
- The US has extended the reach of restrictions on persons on the SDN List by adding some Russian SDNs to the US Commerce Department's Entity List
 - Prohibits exports, reexports and transfers (in-country) by any person – **not just US persons** – of items subject to US export control jurisdiction – even items not on a control list, e.g. EAR99 items – to such designated persons

EU Freezing Sanctions – Russia/Ukraine

- The politics of imposing Ukraine-related sanctions on Russia are very different in the EU than in the US
- The EU is very dependent on gas supplies
- Some EU member states are more dependent on trade with Russia than others, and other member states are more concerned about possible future aggressive moves by Russia than others – difficulty in getting unanimity

EU Freezing Sanctions

- Funds and economic resources (broadly defined) belonging to, owned or controlled by a freezing sanctions target are required to be frozen
- Funds and economic resources (including goods) may not be made available, directly or indirectly, to or for the benefit of a designated sanctions target

US Sectoral Sanctions

- A new phenomenon
- Persons designated as targets of US sectoral sanctions are not “blocked” or listed on the SDN List
- Instead a separate Sectoral Sanctions Identification List (“SSIL”) – yet another list to screen
- Not all transactions with persons on the SSIL are prohibited, just those specified in the implementing sectoral sanctions directives
- The OFAC 50% rule applies to entities owned by one or more persons on the SSIL

US Sectoral Sanctions – Financing

- Apply to SSIL-listed companies in the financial, energy and defense sectors and companies 50% or more owned by one or more of them
- Prohibition on transactions in the US or by a US person in provision of financing for or other dealings in:
 - “New” debt of more than 30 days maturity (formerly 90 days), or new equity in listed **banks**
 - “New” debt of more than 90 days maturity of listed **energy sector companies**
 - “New” debt of more than 30 days maturity of listed **defense sector companies**

US Sectoral Sanctions – Energy

- SSIL sanctions prohibit without a license supply from the US or by a US person to listed oil and gas companies of goods, services or technology when intended for certain deepwater, Arctic offshore and shale projects in Russia

US Sectoral Sanctions – Energy

- US Commerce Department sectoral sanctions apply to exports, re-exports and in-country transfers of items subject to US export controls based on:
 - Entity List: all items destined for energy companies listed on the Entity List when intended for certain oil and gas projects
 - End-use of particular items: items listed under specific ECCNs and Schedule B numbers intended for certain types of Russian oil and gas projects or if end-use is unknown

US Sectoral Sanctions – Defense

- “China Rule” military end-use/end-user restrictions are extended to Russia
 - Applies to targeted ECCNs only

US Sectoral Sanctions – Access to Capital

- Intended to deny access to the US financial markets
- Letters of credit where SSIL-listed entity is the applicant
- Issues relating to revolving credit facilities and rollovers of debt
- What about past due debt in excess of 30 days?
- All other activities with SSIL-listed companies are permitted:
FAQ 371: US financial institution may continue to maintain correspondent accounts and process dollar clearing transactions
- Nonetheless, these sanctions have a chilling effect on the willingness to deal with listed companies

EU Sectoral Sanctions – Access to Capital

- Direct or indirect purchase, sale, brokering or assistance in issuance of, or dealing in new transferable securities and money market instruments with a maturity in excess of 30 days (formerly 90 days) of listed Russian financial, energy and defense companies
- Applies to entities established outside the EU owned more than 50% by such an entity and persons acting on their behalf or at their direction

EU Sectoral Sanctions – Access to Capital

- Transferable securities negotiable on the capital markets with the exception of instruments of payment and include shares and bonds
- Money market instruments are those normally dealt with on the money market, such as treasury bill, c/ds, commercial paper (and exclude instruments of payment)
- This restriction is narrower in scope than the US financial sectoral sanctions

EU Sectoral Sanctions – Access to Capital

- However, a prohibition new loans or credit with a maturity in excess of 30 days to any of the listed financial, energy or defense companies was recently added to the EU sectoral sanctions
- Exceptions: Loans or credits having a specific and documented objective to provide financing for non-prohibited exports and imports of goods and non-financial services between the EU and Russia, or to protect solvency of an EU company owned more than 50% by a listed company

EU Sectoral Sanctions – Energy

- Sale, supply, transfer or export of listed items with specific tariff or CN Codes thought to be useful in the oil industry (not identical to US Schedule B numbers) if for use in Russia, and for related technical assistance, financing and financial assistance
- Absolute license requirement regardless of end-use, but a license may be granted if not for deep water exploration, arctic oil exploration or shale oil projects in Russia – note, unlike US, does not include gas
- License may also be granted if there was a pre-existing contract obligation

EU Sectoral Sanctions – Ukraine/Russia: Energy Sector

- Drilling, well testing, logging and completion services, or supply of specialized floating vessels necessary for deep water oil exploration and production, arctic oil exploration and production or shale oil projects in Russia prohibited
- Grandfather provision for execution of obligations arising from a contract or framework agreement concluded before 12 September or ancillary contracts necessary for execution of such contracts
- Exception where services necessary in connection with human health and safety or environmental harm

EU Sectoral Sanctions – Ukraine/Russia: Defense Sector

- Prohibited to supply dual-use goods and technology (items described on the Dual-Use List under the EU dual-use export control Regulation 428/2009 as amended), and to provide related technical assistance, brokering, financing or financial assistance to listed defense-related companies
- Prohibited to supply dual-use goods and technology intended for military end-uses or end-users

EU Sectoral Sanctions – Defense

- Grandfather provision for execution of contracts concluded before 12 September
- Exclusion from prohibition for such items intended for the aeronautics and space industry for non-military use or end-users and for maintenance and safety of existing civil nuclear capabilities within the EU for non-military use or end-users

EU Sectoral Sanctions – Crimea and Sevastopol

- No imports of items originating in Crimea or Sevastopol or related financing
- License requirement for sale, supply, transfer or export of listed items thought to be useful in connection with certain infrastructure projects
- Prohibitions on investments and financing of certain infrastructure in the areas of transport, telecommunications or energy, or relating to oil, gas and certain listed mineral resources, in Crimea or Sevastopol, as well as related technical assistance and brokering services

Comparison Between US and EU Sanctions

- US: no sunset provisions
- EU provisions will expire unless renewed:
 - Freezing sanctions – March 2015
 - Sectoral sanctions – 31 July 2015
 - Crimean and Sevastopol – 23 June 2015

Sanctions and Banks

- Over the last several years, there have been a number of cases against banks for sanctions violations involving very high fines – principally US enforcement and involving non-US banks
- US DOJ, NY prosecuting authorities and bank regulators, OFAC
- But also non-US bank supervisors – e.g., Netherlands, Switzerland, UK's Financial Services regulator

Sanctions and Banks

- Stripping or concealing information as to origin or destination of funds which enabled US sanctions with respect to those countries to be evaded and screening systems to be circumvented
- Misrepresentations, false statements and documents

Sanctions and Banks

- Huge fines in the hundreds of millions of dollars imposed by the US on European banks
- Most recently close to \$9 billion fines imposed on BNP Paribas, plus suspension of dollar clearing rights

Sanctions and Banks

- All this has made dealing with international banks more difficult particularly where sanctioned countries and targets may be involved
- Banks acting as gatekeepers
- Chilling effect on the willingness of banks to engage in transactions or seek authorisations even where a transaction would be permitted or would receive an authorisation

Compliance – Good Practice

■ Screening

- At client intake
- Ongoing screening of customer base
 - ◆ Updates to target lists
- Transactions screening
 - ◆ All parties to a transaction:
 - Customers, end-users
 - Freight forwarders
 - Banks

Compliance – Good Practice

- Screening is not enough – Is the transaction prohibited?
 - The target list may not identify a prohibited transaction – important to understand the rules
 - End-use and end-user restrictions apply!

Due Diligence

- Ownership and control concepts make due diligence a challenge
- Difficulties of ascertaining ownership
- How much due diligence is enough?

Conclusion

- Economic sanctions are extremely complex
- Many unanswered questions
- Screening and due diligence to identify transactions potentially caught are important
- Due diligence in M&A and investment transactions is of growing importance

Questions?

Contact Information

- Anita Esslinger, Partner, Bryan Cave LLP, London and Washington D.C.
anita.esslinger@bryancave.com +44 (0) 20 3207 1224; 202-508-6333