PHILLIPS LYTLE LLP CLIENT ALERT
INTERNATIONAL BUSINESS LAW

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Navigating Escalating Russia Sanctions

American businesses—exporters, manufacturers, financial institutions—and their customers and partners abroad may be feeling a sense of whiplash from the past few days of regulatory developments tied to foreign events.

Starting with President Biden's issuance of Executive Order 14065 (EO) on February 21, 2022, Russia's invasion of Ukraine has generated a snowballing cascade of sanctions from the United States (U.S.), European Union (EU) and independent nations in a response without recent precedent in scope and pace of enactment.

The initial sanctions under that EO were relatively modest and were applicable to transactions relating to the "breakaway" regions of Luhansk and Donetsk. But as the week (and the scope of Russian military operations) progressed, the U.S. and EU—and others—responded with broadened measures, including a new round of sanctions pursuant to Executive Order 14024, including:

- Restrictions on key Russian banking institutions;
- Designation (blocking) of certain specified individuals and their families (primarily associated with the Russian regime and/or the sanctioned institutions freezing their assets outside of Russia, and prohibiting transactions with U.S. companies or persons); and
- Increased restrictions via export regulations on Russian access to U.S. technology and technical products.

Commercial and financial pressures on the Russian system were further tightened by freezing the foreign assets of the Central Bank of Russia, banning U.S. dollar transactions and cutting off its access to much foreign currency, as well as imminent, restricted access to the Society for Worldwide Interbank Financial Telecommunications (SWIFT) international bank messaging system. A number of EU countries and Canada have closed their commercial airspace to Russian carriers. Further sanctions and restrictions may be anticipated.

Imposition of these measures does not come without costs. U.S. businesses face an array of heightened risks and challenges as these restrictions take effect. This alert points out the most salient issues now confronting U.S. companies navigating transnational trade and finance, and suggests appropriate steps to mitigate legal and business risk.

SANCTIONS

1. **Financial Institutions.** The successive sanctions apply to a number of Russian banks with the greatest impact involving those on the Central Bank of Russia—freezing its foreign assets and prohibiting dollar transactions dramatically impairs Russia's ability to bolster the ruble (at this writing, 105 to the U.S. dollar) and staunch foreign currency outflows; the blocking of VTB Bank and its affiliates, freezing its U.S. and western assets, and prohibiting any U.S. person from transacting business with or through any of its accounts; and restrictions on Sberbank which, while not "fully blocked," is (effective March 26, 2022) denied correspondent and "pay-through" bank relationships, effectively denying it the ability to conduct or clear transactions in U.S. dollars. Prior to sanctions, Sberbank and VTB together made up over 60% of the total asset value of the Russian banking system. A further Directive

under EO 14024 prohibits any dealing in new equity or debt (of over 14 days) of a list of Russian banks (including Sberbank) and companies (including Gazprom) under so-called "menu-based sanctions." An estimated 80% of the $46 billion in global foreign exchange transactions by Russian banks are in U.S. dollars.

Two notes:

a. It was recently announced that access to SWIFT may be denied to a number of yet-unnamed Russian banks, further impairing access to the global trading system. There had been earlier disagreement among western countries as to whether such a move was advisable, but events appear to have pushed toward imposing at least some exclusions.

b. The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) announced on February 28, 2022, that its measures against the Central Bank of Russia were not a "total block," as OFAC is authorizing some transactions that are "energy-related"—just not by U.S. persons (see Energy below).

2. **Exports.** For companies trading, or financing trade, with Russian customers/partners, the new 15 C.F.R. 746.8(a)(1) (the "Rule") greatly expands export controls to Russia, imposing a license requirement on all exports, reexports, and in country transfers to or in Russia for items subject to the Export Administration Regulations and described in Categories 3-9 of the Commerce Control List. Fifty-eight (58) of these items (Export Control Classification Numbers or ECCNs) were not previously controlled for Russia. In addition, 49 Russian military end users are newly moved to the Entity List, meaning not only that certain products and technologies are prohibited for non-licensed export; so is transacting any non-licensed business with them whatsoever. The list, "Implementation of Sanctions Against Russia Under the Export Administration Regulations (EAR)" (pdf)[1], which contains a number of major Russian companies, can be found at the Office of the Federal Register (OFR) website.

Notably, the new Rule expressly excludes "deemed exports," so companies need not seek new authorizations for Russian citizen employees on-site. Besides broadening licensing requirements, the Rule also applies new threshold definitions and restrictions revising the Foreign Direct Product rules regarding exports of made-with-U.S. or U.S.-owned technology or components.

3. **Energy.** In a news conference held February 24, 2022, President Biden stated, "… in our sanctions package, we specifically designed to allow energy payments to continue. We are closely monitoring energy supplies for any disruption." The Biden administration is "threading a needle" on this issue, very possibly because of the impact on western alliance economies (as well as the effects of inflationary pressures in domestic politics). Germany's suspension of the Nord Stream2 project—which certainly assisted the Biden administration in eventually rescinding its sanctions waiver regarding the pipeline—is the most visible and, to some, politically surprising effort in this vein.

In its press release and FAQs issued February 24, 2022, OFAC includes a General License (GL) 8 for energy-related payments until June 24, 2022—however, in an important note, states that the license doesn't allow dealing through a sanctioned bank: ". . . in order for a U.S. financial institution to engage in transactions authorized by GL 8, all funds transfers related to energy

1 https://public-inspection.federalregister.gov/2022-04300.pdf

involving one or more Covered Entities must be processed indirectly through a non-sanctioned, non-U.S. financial institution." What this appears to mean is that payments are permitted as long as they are made through a non-sanctioned, non-U.S. (e.g., European) bank.

4. **Individuals.** A number of individuals—primarily persons with ties to sanctioned banks or with Russian official foreign policy roles—have been added to the U.S. Department of the Treasury's list of Specially Designated Nationals, their assets frozen/blocked where found, and with whom U.S. persons and entities may not do any business. The most recent additions: President Vladimir Putin and Russian Foreign Minister Sergey Lavrov.

BUSINESS CHALLENGES

Among the more immediately foreseeable concerns and potential challenges for U.S. businesses in this new environment, whatever its duration, are the following:

- **Cyberattack.** In sanctions, as in war, the opposition gets a vote. The most obvious means for Russia to retaliate and raise the discomfort level for U.S. businesses is one at which it has already proven its willingness and capability: cyberattack, including "wipers" and other malware; interruption of vital systems of production, communication or e-commerce; and distributed denial of service attacks. Companies must be on heightened alert for such threats and should ensure that cyber defenses—not just technology—but business procedures, employee training and contingency plans are tested and up-to-date.
- **Supply Chain Disruption.** Existing supply chain issues (already significant) may be made even greater due to restricted access to certain zones due to conflict (along with heightened insurance premiums); energy shortages increasing transportation and production costs; and varying costs of raw materials and/or commodities. Airspace closures almost certainly will add to shipping costs; financial institution restrictions and uncertain payment processing issues may affect both supply and credit availability. Companies doing direct business with Russia will be particularly affected.
- **Business Continuity.** Many U.S. businesses learned much from operating through the pandemic and have acquired new levels of resilience; however, the above-cited factors bring entirely new challenges and uncertainties. These should be planned for, wherever possible.
- **Export Restrictions.** The new restrictions demand careful review by any exporter doing business with Russia, or with a customer who in turn reexports to Russian customers. Especially close attention should be paid regarding exports for which a license is now required, and to the customers in Russia to whom any export (even many currently classified as EAR99) is newly classified as subject to a presumption of denial. There are License Exceptions, as always, but the new Rule indicates that they will be fewer in number for such end users and more narrowly applied.

RECOMMENDATIONS

As a general matter, companies doing business with or through Russian counterparties are advised to:

- Review and reinforce all cybersecurity procedures and training, with an emphasis on contingencies for business interruption.
- Specifically for exporters, review product lists and current orders for possible applicability of new classifications and restrictions; increase (or implement) careful compliance screening of all transactions relating

to Russian end users (or to their suppliers); if necessary and technically possible, use commercial screening software automatically to "flag" problematic orders for review prior to fulfillment.

- For all transactions, anticipate escalating fuel, transportation, insurance and volatile commodities costs.
- For existing international contracts, review *force majeure* and commercial impossibility clauses for applicability. In drafting agreements going forward, work with counsel in crafting specific risk reduction/mitigation language regarding potential impact of these and related sanctions.
- Consult with expert counsel in reducing risk with regard to making/receiving lawful payments under current restrictions.
- With counsel, carefully continue to monitor the rapidly changing sanctions environment to insure compliance and risk mitigation measures.

For questions or further assistance regarding foreign business restrictions or regulations, please contact James Kevin Wholey or the Phillips Lytle attorney with whom you have a relationship. ■

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