

## **Russia-Ukraine Sanctions and export restrictions: new challenges for compliance & risk**

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### **Abstract**

The economic and political consequences that modern sanctions regimes imply should not be underestimated. Those regimes directly affect foreign trade and create new challenges for legal and compliance departments of both multinational companies and medium-size enterprises. The price of non-compliance might be too high: from administrative fines, profits confiscation, and criminal prosecution to withdrawal from public tenders, reputational risk, and loss of trust from authorities. In this article, we explore one of the recently imposed sanctions regimes – the Russia-Ukraine-related sanctions. Which risks do these sanctions incur for organizations doing business in Russia and/or with Russian counterparts?

### **The impact of sanctions on internal compliance of European enterprises**

Since 2014 sanctions have become a sort of weapon, which serves exclusively political purposes, but, at the same time, affects mostly the global market of goods and services. In such conditions, a question of export compliance arises even for those enterprises, who have never faced challenges related to international trade before.

Nowadays, export compliance touches not only multinational companies with global presence and legal representation in sanctioned countries, but also small and medium enterprises based in Europe and the U.S. dealing with potential sanctioned parties in Russia, Ukraine, Belarus, Iran and other countries where currently, international trade is restricted both by EU regulations and U.S. authorities.

Of course, sanctions regimes, which usually last for years, existed before, but it seems that no one paid too much attention to them outside the US. In 2014 the paradigm changes. To standard embargo countries such as Cuba, Syria, Iran, Sudan and North Korea and SDN (Specially-Designated Nationals) list, Sectoral Sanctions list (SSI) was added. This new sectoral sanctions list included the so-called Ukraine-related entities located in Russia, Eastern Ukraine and Crimea.

This type “sectoral sanctions” were developed in a very quick and not really comprehensive manner as a response to certain political actions. That is why some time was needed to adjust them and issue clarifications (such as OFAC’s F.A.Q.s).

Compliance with these “inventions” has become a real issue mostly for foreign banks who needed to do screening of all their transactions and manually check ongoing contracts and other papers in order to comply with financial restrictions, including possible financing in new debt for more than 30 days (both US and EU regulations), and transferable securities operations & money-market instruments ban (EU restrictions).

Those financial restrictions affected also other industries and foreign trade segments. “Payment terms” restriction has become applicable for FMCG, IT and other industries who deal with sanctioned parties (e.g. banks and oil & gas companies). Moreover, all companies of European and US origin (or with US persons\* employed within such companies), regardless of their specifics, which have contracts with entities under SSI, should have followed this rule.

A truly resonance was caused by Directive 4 under Executive Order 13662 issued by OFAC (“support of exploration or production for deepwater, Arctic offshore, or shale projects in Russia”). To comply with this Directive all foreign suppliers of Russian Oil & Gas companies such as Gazprom, Rosneft, Gazpromneft and Surgutneftegaz, should have elaborated internal documents, such as End-User Confirmations.

Those would have permitted them to continue dealing with the sanctioned companies, at the same time, being compliant with the regulations.

#### **What an Italian enterprise should know to assure legal compliance with EU and US export restrictions?**

- Embargo on provision of goods and services to Crimea and asset freeze of certain Crimean entities;
- Restrictions applicable to payment terms and other types of dealing with new debt
- Directive 4 compliance if dealing with Oil&Gas companies (end-user confirmation)
- Import restrictions as part of import substitution strategy in Russia.
- Dealing with non-civil entities in Russia & CIS.

Let’s focus on each of these topics.

#### **Crimean embargo**

What a company should do to assure compliance with this particular restriction?

First of all, internal measures should be put in place. For example, confirmations from the sales force, that “to the best of their knowledge”, no products or services of the company will be used in Crimea and Sevastopol, should be obtained.

Sometimes it is really difficult to understand from legal standpoint (even after proper due diligence) whether a particular customer operates in Crimea. For example, a major Russian bank or other entity after annexation of Crimea might obtain an affiliate or other type of legal presence. However, until such bank or other company informs directly its counterpart about intention to use products and services in Crimea, you should rely on the available official information such as sanctions databases, employees confirmations etc. Moreover, there is a certain exception for Crimean embargo. If goods and services delivered have physical persons as a final end-user (let’s imagine, that company X sells PCs via distributors in Crimea), these restriction can be omitted (in case of compliance with EU regulations, and not US ones). However, said provision definitely affects B2B transactions in the region. You can find the complete list of types of goods and services whose delivery to Crimea and Sevastopol under this provision is prohibited here [http://europa.eu/newsroom/highlights/special-coverage/eu\\_sanctions/index\\_en.htm#4](http://europa.eu/newsroom/highlights/special-coverage/eu_sanctions/index_en.htm#4) (Consolidated version of Council Regulation (EU) No 692/2014, Annex II).

#### **Financial restrictions**

What shall a company need to ensure compliance with financial restrictions of both EU and US authorities? In other words, what does it mean - dealing in a new debt not more than 30 or 90 days (depending on the entity) with some of Russian entities listed in sectoral sanctions?

If we are talking about a bank, it will probably imply additional checks and due diligence potentially including hiring a dedicated specialist who will have to control all the transactions on possible breach of these regulations).

If we are talking about FMCG, IT, Pharma or other production company, it would be enough for its Finance&Administration department to have a list of sanctioned entities, and conduct a routine check of payment terms (which are also considered dealing with a new debt) on its own.

If we are talking about specific products' (such as software) to be used for potential customer's IPO or other money-market instruments / transferable securities-related cases, it occurs to get an additional confirmation from internal stakeholders (and sometimes from the customer). For example, an EU-sanctions listed bank which purchases EU-made software and then goes for an IPO might become a problem for a company who delivered its products to such a bank.

### **Oil&Gas: Directive 4 by OFAC**

The Directive 4 issued by OFAC and the corresponding measures imposed by the European Union mean that neither EU nor US persons should be involved in support of exploration or production for deepwater, Arctic offshore, or shale projects in Russia – both directly or indirectly. This measure suggests that if an entity continues to deal with another entity (Oil company Y) sanctioned under Directive 4, it will have to obtain a confirmation from the sanctioned customer Y that it is not going to use the provided goods or services for the purposes prohibited by the Directive. Said confirmation may have the same format as a standard End-User certificate, but there are no precise requirements: every company chooses a template that is more suitable for its industry.

### **Import restrictions**

For most of the industries (except for software and banking), a problem of customs usually arises. There have been not so many changes made into the Russian customs policies recently, except for the cases of products, which fell under Russian counter sanctions, and, therefore, should be destroyed just upon arrival at the customs office. However, an important thing to keep in mind with this regards will be a strategy of import substitution that is being built on several legislative acts which will indirectly influence exports of foreign goods and services in Russia.

Said strategy is a constant work-in-progress, and there are not so many concrete measures taken by the government by the moment, but we suggest keeping this risk in mind before entering the market or planning the further expansion.

### **Working with Russian military sector**

Though not so many Russian entities were directly listed in the Russia-Ukraine sanctions lists, working with military sector in Russia implies certain risks, such as a necessity to apply for an export license from the authorities of the countries where exports are originating from.

Now European enterprises should not only be compliant with Dual-Use regulations and non-proliferation of arms strategy (like it was before), but also take into account that issuing of a standard export license for their military customers may take much more time than before, and sometimes even rejections can follow. That, for sure, affects customer relationships in a long-term perspective.

You can read about current "military-related" restrictions here:  
[http://europa.eu/newsroom/highlights/special-coverage/eu\\_sanctions/index\\_en.htm#4](http://europa.eu/newsroom/highlights/special-coverage/eu_sanctions/index_en.htm#4)

## Conclusions

Export Compliance has recently obtained certain importance in General Compliance and Risk Management due to current political situation of general instability in the world. Firms, therefore, need to dedicate more effort to this part of internal compliance in order not to lose money and reputation. No prosecutions open at the moment concerning Russia-Ukraine sanctions does not mean that there will be no consequences in the future for those who are not compliant now. Typically, sanctions regimes last for 5-7 years and potential breaches are often being investigated right before lifting a particular regime, or, sometimes, even after. That is why we are talking about long-term compliance strategy to be developed and followed.

Currently, some high-level discussions about possible lifting of Russia-Ukraine-related sanctions in July 2016 (in case of meeting the conditions of Minsk agreements) are held. However, there is no certainty if all the sanctions will be waived or only part of entities sanctioned will be excluded from the list.

In any event, as experience tells us, absence of law knowledge doesn't relieve us from responsibility. The same saying is completely valid for export compliance as a whole.

*\*OFAC defines a "U.S. Person" as: 1. U.S. Citizens, regardless of where they live in the U.S.; 2. U.S. Permanent Residents (Green Card Holders); 3. All persons or entities within the U.S.; 4. U.S. Citizens or U.S. Permanent Residents located outside the U.S.; 5. All U.S. incorporated entities and their foreign branches or subsidiaries owned or controlled by U.S. entities.*