

CHANGES TO US SANCTIONS ON RUSSIA MAY AFFECT BUSINESS RELATIONSHIPS

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On August 2, 2017, US President Donald Trump signed into law the Countering America's Adversaries Through Sanctions Act (the "Act"), which imposes additional sanctions on Iran, North Korea and Russia. The Act had been passed by both houses of Congress with a strong bipartisan vote. For a description of the initial Senate bill, see our earlier briefing. The Act's changes to sanctions on Iran and North Korea are likely to have few consequences to most parties, in that they add restrictions to activities that were already subject to significant restrictions. However, it is likely that the Act will have significant consequences on certain sectors of the Russian economy, as well as the ability of certain Russian companies to operate outside Russia.

EXISTING SANCTIONS

In 2014, in response to Russia's annexation of Crimea and apparent support for insurgents in eastern Ukraine, the US imposed significant "sectoral" sanctions on Russia. These sanctions, administered by the US Department of the Treasury's Office of Foreign Assets Control ("OFAC"), targeted major companies operating in the Russian financial, energy, and defense sectors. However, unlike traditional "blocking" sanctions, which generally block all transactions between the US and the sanctioned party, sectoral sanctions merely prohibited a US person from providing financing to the entities named on the Sectoral Sanctions Identification List, and from assisting in the exploration or production of Arctic offshore, deepwater or shale oil within Russia.

Additional blocking sanctions target individuals and entities affiliated with President Vladimir Putin, and that have engaged in human rights violations and cybercrimes, among others.

HIGHLIGHTS OF THE ACT

Codification of existing sanctions. The Act codifies most of the existing sanctions, requires the President to undergo special procedures to repeal, relax or waive them and, in certain cases, prohibits the President from taking any such actions. This makes it more difficult for the President unilaterally to take action to waive or repeal sanctions. The President could still potentially grant a broad general license to engage in transactions prohibited by the Act, although such action could be challenged.

New sectoral sanctions. The Act adds two new sectors of the Russian economy to

the existing sectors targeted by sanctions: railways and metals/mining. The Senate bill also included sanctions on shipping, but this was removed from the final Act. As a result, significant state-owned Russian railway and metals/mining companies may become subject to sanctions similar to the sectoral sanctions already targeting the Russian financial and energy sectors. The Act does not *require* that such sanctions be imposed, and the precise contours of these sanctions (if any) will depend on directives to be released by OFAC.

Modifications to existing sanctions: prohibitions on new debt. Existing sanctions prohibit US persons from dealing in new debt of designated Russian companies with a maturity of greater than 30 days (for designated financial companies) or 90 days (for designated energy companies). The Act reduces the maturity threshold from 30 to 14 days (for financial companies) and from 90 to 60 days (for energy companies). For this purpose, trade receivables are treated as debt, so US persons engaging in permitted transactions with designated Russian companies should ensure that invoices are paid promptly, to avoid an “accidental” debt issuance of longer than 14 or 60 days, respectively. The new thresholds will take effect 60 days after OFAC releases a revised directive.

Modifications to existing sanctions: Arctic offshore, deepwater or shale oil. Existing sanctions prohibit US persons from assisting in exploration or production of Arctic offshore, deepwater or shale oil that could produce oil in Russia (including Russian maritime areas). The Act expands the prohibition to apply to “new” Arctic offshore, deepwater or shale projects that have the potential to produce oil *anywhere in the world*, if the project involves a designated Russian entity that has a “controlling interest” or a 33% or greater non-controlling interest in the project. OFAC has yet to release guidance regarding what constitutes a “new” project, but presumably existing projects will be exempt if they can satisfy OFAC’s requirements, if and when released. OFAC also has yet to release guidance regarding what constitutes a “controlling interest,” and how the 33% non-controlling interest is calculated. The new thresholds will take effect 90 days after OFAC releases a revised directive.

Extraterritorial sanctions: assistance with Russian Arctic offshore, deepwater or shale oil. Prior law provided that the President *may* impose “extraterritorial sanctions” (also called “secondary sanctions”) on *non-Russian* individuals and entities that make significant investments in extraction of Russian Arctic offshore, deepwater or shale oil. The Act provides that the President *shall* impose such sanctions unless s/he determines that it is not in US national interest to do so. Unlike the sectoral sanctions described above, these sanctions apply only to oil in Russia.

Extraterritorial sanctions: assistance with energy export pipelines. The Act directs the President, in co-ordination with US allies, to impose extraterritorial sanctions on *non-Russian* individuals and entities that make significant investments in Russian energy export pipelines. The earlier Senate version of the bill did not include the requirement that the sanctions be imposed in co-ordination with US allies; presumably this was added to assuage various EU governments that had criticized the bill, in part, on the grounds that the bill could sanction participants in the Nord Stream 2 project, which will export gas through the Baltic Sea from Russia to the EU. (In a separate, non-operative provision, the Act expresses US opposition to the Nord Stream 2 project as a matter of policy.)

Other extraterritorial sanctions. The Act directs the President to impose extraterritorial sanctions on *non-Russian* individuals and entities that engage in significant transactions with Russian defense or intelligence agencies, that assist in privatizing Russian state-owned entities in a manner that benefits Russian officials, or that supply arms to Syria. Unlike the pipeline sanctions described above, these sanctions can be enacted directly by the US, and do not require co-ordination with US allies.

Additional conduct-based sanctions. The Act strengthens existing conduct-based sanctions against Russia by imposing sanctions on parties that disrupt cyber security and commit human rights abuses.

CONSEQUENCES OF THE ACT

It is impossible to predict the effect of the Act with any certainty. Some of the provisions, such as the shortening of time that permissible debt of designated financial and energy companies can remain outstanding, are relatively straightforward. Other provisions, however, will remain unclear until designations and/or guidance is released. Based on the timeframes in the Act and precedent, we would generally expect most guidance to be released by the next three to six months (i.e., in late 2017 or early 2018). Some of the questions remaining open include:

- Under what circumstances and to what extent can codified sanctions be authorized by general license and/or repealed through the Congressional review mechanism?
- What Russian railway and/or metals/mining companies (if any) will be designated as subject to sectoral sanctions, and what sanctions will be imposed?
- For purposes of the Arctic offshore, deepwater and shale oil restrictions, what constitutes a “new” project (an old project would not be subject to these rules), and how is a “controlling interest” determined or a 33% interest measured?
- Will extraterritorial sanctions be imposed in respect of energy export pipelines? Is the Nord Stream 2 project (or similar projects) at risk? If US allies refuse to co- operate, will there be any such sanctions?

Ultimately, practitioners should closely monitor upcoming sanctions to be released by OFAC imposed under the Act, and should document and structure their transactions to decrease the likelihood of a sanctions violation if and when the new sanctions take effect. We will continue to monitor developments and release any updates as and when appropriate following the release of designations and/or further guidance.

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