

Ukraine-related Sanctions: New U.S. Statute Creates Secondary Sanctions Targeting Certain Dealings with Russia

On December 13, 2014, Congress passed the Ukraine Freedom Support Act of 2014 ("UFSA"), which President Obama is expected to sign into law within the next few days. UFSA does not significantly expand the substantive scope of existing U.S. (and EU) sanctions, and the new sanctions are generally discretionary rather than mandatory. However, UFSA does place entities acting outside U.S. jurisdiction at increased risk for engaging in targeted Russia-related activity.

UFSA creates a program of so-called "secondary" sanctions, similar to those that have been imposed with respect to Iran in recent years. Pursuant to secondary sanctions programs, foreign persons and entities may themselves be sanctioned by the United States for engaging in certain transactions that would be prohibited for U.S. persons, even if they do so entirely outside U.S. jurisdiction. In effect, non-U.S. entities may be punished for engaging in targeted transactions by having their access to the United States' markets and financial system restricted. Foreign financial institutions in particular may face increased risk.

In brief, UFSA:

- requires the President to impose certain sanctions against Rosoboronexport, the Russian state-owned arms exporting entity, and other entities that the President finds are involved in Russian transfers of defense articles to Syria or to entities other than the recognized governments of Ukraine, Moldova, or Georgia;
- authorizes the President to impose a menu of sanctions against foreign persons who "knowingly make a significant investment" in a Russian Arctic offshore, deepwater, or shale project for the production of oil;
- requires the President to impose restrictions on debt or equity investment in Gazprom if he determines that Gazprom is withholding significant natural gas supplies from NATO members or countries such as Ukraine, Georgia, or Moldova; and

- authorizes the President to restrict access to U.S. correspondent accounts for foreign financial institutions that he determines have engaged in significant transactions relating to:
 - any sanctionable investment in a Russian Arctic offshore, deepwater, or shale project for the production of oil;
 - any transaction for an SDN designated by the U.S. under the Ukraine-related sanctions (not including entities subject to more limited sectoral sanctions and identified on the SSIL list), beginning 180 days from the date UFSA is signed; or
 - sanctionable arms sales.

Sanctions Relating to the Defense Sector:

UFSA requires the President to impose a minimum of three out of a menu of nine specified possible sanctions (up to and including designation as an SDN subject to full U.S. sanctions) against Rosoboronexport, as well as against any other entity owned or controlled by the Russian government or Russian citizens that knowingly manufactures defense articles transferred to Syria, or to entities other than the recognized governments in Ukraine, Moldova, or Georgia, or transfers, brokers the transfer or otherwise assists in the transfer, of such articles into these countries.¹ The President is also required to impose sanctions against any entity (Russian or not) determined to knowingly assist, sponsor, or support the activities described in the previous sentence. Besides Syria, Ukraine, Moldova and Georgia, the President is also authorized to designate other countries such as Poland, Lithuania, Latvia, Estonia and the Central Asian republics as “countries of significant concern” for purposes of this section of

¹ The list of nine sanctions involving the defense and energy sectors that the President may impose include:

1. Prohibition of assistance from the Export-Import Bank of the United States;
2. Prohibition against procurement of goods and services by United States executive agencies;
3. Prohibition of provision of defense goods and services to the sanctioned foreign person or entity;
4. Prohibition of licensing of arms and other dual-use exports for the benefit of the sanctioned foreign person or entity;
5. Prohibition against engaging in certain U.S. property transactions, but not including the authority to restrict the importation of goods;
6. Prohibition against certain banking transactions, including transfers of credits and payments involving an interest of the sanctioned foreign person or entity;
7. Prohibition of certain investments by U.S. persons in equity and debt transactions involving the foreign person;
8. Exclusion of foreign sanctioned persons from the United States and revocation of visas or other documentation; and
9. Imposition of any of the aforementioned sanctions against the executive officers of a foreign sanctioned entity.

UFSA, such that producers, transferors or brokers of defense articles that are transferred to such countries will be subject to the imposition of the same set of sanctions.

The sanctions against Rosboronexport are mandatory. Sanctions against other entities engaged in the targeted arms-related activities are expressed as mandatory, but they will not actually be imposed unless the Administration makes a determination that the target is engaged in sanctionable activity. The statute also provides for a variety of waivers of sanctions in the interest of U.S. national security.

Sanctions Relating to the Energy Sector:

UFSA also authorizes the President effectively to extend existing sanctions targeting Russian deepwater, Arctic offshore, or shale projects for the production of oil by imposing secondary U.S. sanctions against any entity that “knowingly makes a significant investment” (“significant investment” is undefined) in such projects. These sanctions may be imposed against persons investing in such projects whether or not the person or investment activity has any connection to U.S. jurisdiction. The menu of possible sanctions is the same as that for defense-related transactions.

Second, UFSA authorizes, but does not require, the imposition of additional licensing requirements or other restrictions on the export or reexport of items for use in the Russian energy sector.

Finally, UFSA requires the President to impose restrictions on debt and equity transactions (parallel to those previously imposed under U.S. sectoral sanctions against other Russian energy companies) if the President determines that Gazprom is withholding significant amounts of natural gas from NATO member states or other countries “such as” Ukraine, Georgia and Moldova, as well as one or more of the additional sanctions from the menu described above. While the imposition of sanctions relating to Gazprom is mandatory once the President makes the requisite determination, as above the determination itself is not automatic and requires affirmative action by the Administration.

Sanctions Relating to the Financial Sector:

UFSA also authorizes the President to restrict or prohibit access to U.S. correspondent accounts (similarly to the Iranian Financial Sanctions Regulations) for foreign financial institutions engaged in targeted transactions. These secondary sanctions again do not require the use of U.S. dollars or any other U.S. jurisdictional nexus, but they are highly discretionary.

First, foreign financial institutions may be sanctioned if they knowingly engage in significant transactions relating to sanctionable activities involving Russian arms sales,

or involving sanctionable investment in Russian deepwater, Arctic offshore, or shale projects for the production of oil, in each case for persons sanctioned under the UFSA provisions described above. Note that the statute is ambiguous as to whether the person must have been sanctioned under UFSA before the transaction in question for the financial institutions involved also to be sanctioned, or whether the financial institutions and clients involved could be sanctioned together for the same transaction. However, the transaction must be related to activity sanctionable under UFSA (and so, for example, processing a transaction outside U.S. jurisdiction for the sale of goods to a targeted Russian oil project would not appear to be sanctionable for the financial institutions involved). Also note that financial institutions could be vulnerable to the imposition of defense sector sanctions as well as to correspondent account sanctions if they are determined to have knowingly assisted in targeted arms sales.

Second, foreign financial institutions may be sanctioned if, on or after a date that is 180 days after UFSA enters into force, they facilitate significant financial transactions on behalf of any Russian individual or entity that has been designated as an SDN pursuant to UFSA or any Executive Order relating to Ukraine, including Executive Orders 13660, 13661 and 13662. Note that this does not include the Russian energy companies and financial institutions subject to sectoral sanctions only, as they are not SDNs.

If you have any questions, please feel free to contact any of your regular contacts at the Firm, or [Paul Marquardt](mailto:Paul.Marquardt@clearygottlieb.com) of our Washington office, listed on our website at <http://www.clearygottlieb.com>.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

Office Locations

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS

12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS

Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON

City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW

Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT

Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE

Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME

Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN

Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG

Cleary Gottlieb Steen & Hamilton (Hong Kong)
Hysan Place, 37th Floor
500 Hennessy Road
Causeway Bay
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING

Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES

CGSH International Legal Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO

Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299

ABU DHABI

Al Sila Tower, 27th Floor
Sowwah Square, PO Box 29920
Abu Dhabi, United Arab Emirates
T: +971 2 412 1700
F: +971 2 412 1899

SEOUL

Cleary Gottlieb Steen & Hamilton LLP
Foreign Legal Consultant Office
19F, Ferrum Tower
19, Eulji-ro 5-gil, Jung-gu
Seoul 100-210, Korea
T: +82 2 6353 8000
F: +82 2 6353 8099