International Trade Alert

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Ukraine-Russia Crisis: Possible New Sanctions and Export Controls on Russia and Potential Implications for US and Non-US Companies

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Key Points

- The United States, European Union, United Kingdom and other U.S. allies are currently considering a range of severe economic measures against Russia to impose in the event of a Russian military incursion into Ukraine. The United States, European Union and United Kingdom have issued strong warnings to Russia, threatening punitive measures with "massive consequences" and "severe costs" that were not considered in past use of sanctions against Russia, and that they intend to "start at the top of the escalation ladder and stay there."
- The United States, European Union and United Kingdom have broad legal authorities already in place enabling imposition of a range of severe new sanctions and export control measures that can be used to target different sectors of the Russian economy. Sanctions could focus on strategic sectors such as the financial services, energy, defense or technology sectors, and could be comprised of blocking measures, targeted sectoral sanctions, sovereign debt restrictions and/or other measures. Sanctions could also be imposed on individuals, including President Putin, other Russian government officials and additional prominent Russian business figures.
- Recent focus in the U.S., EU and U.K. government options review has been, in particular, on the potential for imposition of impactful sanctions on major Russian financial institutions, which could have a dramatic impact on companies that directly or indirectly operate within or involving markets associated with Russia, as well as broader global financial markets. In addition, there has been significant focus this week on possible action against the Nord Stream 2 gas pipeline. Although sanctions on the project previously have been waived by U.S. officials in consideration of EU member state energy supply concerns, this week U.S. officials indicated that the United States will work with Germany to ensure the project does not move forward if Russia invades and statements of German and French officials indicate that they are open to this option and it is very much on the table.
- Recent statements by government officials have also indicated that established export control regulations may be modified and used to block the export or re-export

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of certain U.S.-, EU- and U.K.-origin items to Russia. This could include U.S. deployment of novel extraterritorial export controls, developed in 2020 for use against U.S. concerns associated with the Chinese company, Huawei, to block exports of wholly non-U.S.-origin items if they are designed or produced with certain types of U.S.-origin software, technology or equipment. The impact of this "foreign-produced direct product rule" would depend, to a large extent, on whether the United States applies the rule to all exports to Russia, or limits it to specific companies or sectors (e.g., aerospace, maritime, oil and gas, information technology, telecom and high-tech areas such as those related to artificial intelligence and quantum computing). At this time, U.S. officials appear more likely to target Russian industrial production in key sectors than general consumer products affecting ordinary Russian consumers.

- Even if Russian forces do not proceed further into Ukraine, it is foreseeable that new measures will be imposed on Russia in connection with the current crisis, although the nature and severity of such measures also is unclear at this time. It is also possible that Russia could respond to such actions with countermeasures of its own that adversely impact business interests of European and American companies.

The potential timing of new sanctions and export controls is still uncertain and may depend on many variables. In the meantime, U.S. and non-U.S. companies have an opportunity to evaluate their direct and indirect touchpoints with Russia and potential exposure to new sanctions, and establish or update compliance safeguards and means to mitigate related risk exposure.

I. U.S., EU and U.K. Response to Date

The United States has adopted a multifaceted response to the recent buildup of over 100,000 Russian troops on the Ukraine border. In addition to significant diplomatic efforts in coordination with the European Union, United Kingdom and other allies, to date, the United States has announced millions of dollars in military aid to help defend Ukraine, increased its troop presence in North Atlantic Treaty Organization (NATO) countries, particularly on the Eastern flank, and sent military advisors to Ukraine. In addition, senior U.S. officials have repeatedly warned that the United States has "developed a high-impact, quick-action response" to "inflict significant costs on the Russian economy and financial system if it were to further invade Ukraine." So far, EU and U.K. officials have stated that they are being intentionally discreet regarding the types of measures they have under consideration. In the United Kingdom, Prime Minister Boris Johnson has also indicated willingness to take further steps to help Ukraine defend itself, including through an increased NATO presence to protect allies on NATO's eastern flank.

A. Possible Sanctions

So far, the United States, European Union and United Kingdom have not publicly committed to any specific sanctions measures, though each jurisdiction has a broad range of legal authorities to deploy new sanctions and export controls against Russia, with numerous options reportedly under consideration. The severity of any measures ultimately imposed will depend on the nature and scale of any Russian action against Ukraine.

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While there has been significant emphasis on all sides regarding the importance of taking action multilaterally, if sanctions are imposed, there will almost certainly be some divergence in the eventual scope and breadth of measures adopted by United States, European Union and United Kingdom given the differing foreign policy and national security considerations of each. The requirement of unanimity in the EU's Foreign Affairs Council foreseeably could result in some watering down of any EU measures while U.K. measures could go further in severity (notably, related to this issue, in Parliament, U.K. Prime Minister Boris Johnson has stated that the U.K.'s job now was to "persuade and encourage our [European] friends to go as far as they can" with the new measures). Despite European energy supply sensitivities, both the European Union and United Kingdom have repeatedly emphasized the severity of their intended response to further aggressive actions by Russia, and, in a recent press call, senior U.S. administration officials highlighted ongoing work with European allies to identify and prepare to deploy alternative backup sources of energy for Europe should Russia curtail European energy supplies as part of its own strategy or countermeasures.

While the Biden-Harris administration already has all of the legal authority it needs to impose impactful new blocking sanctions and other sweeping measures affecting all sectors of the Russian economy, members of the U.S. Congress have introduced legislation that, if enacted in current form, would mandate the imposition of specific new sanctions on Russia. The Biden-Harris administration has endorsed one of these bills, the *Defending Ukraine Sovereign Act of 2022* (introduced by Sen. Bob Menendez (D-NJ) in the U.S. Senate and Rep. Greg Meeks (D-NY) in the U.S. House of Representatives), which would mandate the imposition of a wide range of sanctions on Russia if hostilities in Ukraine increase. While the ultimate language of a compromise bill is currently being negotiated within Congress, we can expect the Biden-Harris administration to utilize some of the measures contained in that bill regardless of whether it is enacted.

There has been heavy speculation regarding the proposals reportedly under consideration based on the public statements that have been made by senior government officials to date.

1. Blocking Sanctions

Several of the more severe options that reportedly are on the table would involve the imposition of additional "asset blocking" (sometimes referred to as "list-based") sanctions by the United States, European Union and United Kingdom on various Russian individuals and entities. These heavy-hitting sanctions impose asset blocking requirements that generally result in virtually all dealings with targeted persons being prohibited. As a result, the impact of these sanctions can be quite substantial and, depending on the nature of the target, can have important ramifications in the global market. These designations could potentially target entities operating in the Russian financial, energy, defense, technology, aviation, industrial or other strategic sectors, including, potentially, entities that have been previously targeted only with "less than blocking" or more targeted sectoral sanctions, or, as the U.S. Congress has long-advocated for, the operator of the Nord Stream 2 pipeline project (which, based on very recent statements from the United States, United Kingdom, Germany and France, appears to now be on the table).

Blocking sanctions could also be imposed on Russian individuals, including President Putin and other Russian government officials, persons in Putin's inner circle and other leading Russian business figures. As is typically the case with U.S. sanctions, any entities that are directly or indirectly owned 50 percent or more by one or more blocked persons are also blocked, regardless of whether such entities are Russian and/or appear on the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) Specially Designated Nationals and Blocked Persons List ("SDN List"). Though the exact scope of the restriction differs between the EU and U.K. sanctions regimes, EU and U.K. persons would be required to freeze funds and assets owned, held or controlled by designated persons, and restricted from making funds or assets available to, or for the benefit of, designated persons. These prohibitions also apply to non-designated entities owned (more than 50 percent) or controlled by designated persons. The European Union and United Kingdom have different approaches towards ownership and control.

While, to date, the United States, European Union and United Kingdom have not officially named any particular future targets for blocking sanctions, U.S. government officials, in particular, have focused in recent weeks on the strong possibility of blocking sanctions being imposed on certain key Russian financial institutions. Notably, the Menendez/Meeks bill, if enacted in current form, would require the U.S. President to impose blocking sanctions on **three or more Russian financial institutions** from a list of 12: Sberbank, VTB, Gazprombank, VEB.RF, The Russian Direct Investment Fund, Credit Bank of Moscow, Alfa Bank, Rosselkhozbank, FC Bank Otkritie, Promsvyazbank, Sovcombank, and Transkapitalbank. The European Union and United Kingdom could similarly designate certain large Russian financial institutions (U.K. Foreign Secretary Truss recently noted that sanctions against banks are well within the U.K.'s range of options), although the European Union and United Kingdom could ultimately adopt a more targeted approach to designations of banks in light of closer European ties to these financial institutions.

Companies should expect significant ripple effects if the United States and/or its allies impose blocking (or even "less than blocking" sanctions, as discussed further below) on any large Russian financial institutions, due to the breadth of their roles in the commercial and retail markets (e.g., whether as lenders, borrowers, brokers, transfer and paying agents, or payment services providers, or related to foreign currency exchanges and ruble clearance, trade finance, insurance and within the secondary market). The effect of designations targeting other sectors could also be very substantial given how integrated Russia and its companies are into the global markets (including companies that are not Russian but that may be owned by one or more blocked Russian persons).

Given this global integration and the notable significance of many of the targets reportedly being considered, OFAC may consider issuing licenses to allow companies to conduct an orderly wind down of activity involving targeted entities, or potentially other licenses to allow for certain very limited activity to continue (as has often been the case recently when OFAC takes action against a significant company with a global footprint). While the Biden-Harris administration has made no official promises so far regarding any such grace periods or carve outs, industry groups continue to press the administration on this point.

In light of the differing policy considerations of the United States, European Union and United Kingdom, businesses should be aware that designations, and the sanctions obligations that flow from such actions, may differ between the jurisdictions. For example, the United States, European Union and United Kingdom could target different individuals or entities, or impose differing restrictions. Accordingly, it will be important to closely examine the specific measures imposed by each legal authority to determine the specific restrictions and limitations applicable to a targeted party in each case. This should include consideration of how differing definitions and approaches to considerations of "ownership" and "control" apply in specific situations.

2. Sectoral Sanctions

As jointly deployed by the United States and European Union in 2014 in response to Russia's annexation of Crimea, the United States, European Union and United Kingdom could impose sectoral sanctions imposing more limited restrictions that can be used to prohibit specific kinds of transactions involving targeted parties short of comprehensive blocking. Sectoral sanctions could target all sorts of activities that are relevant to different strategic sectors of Russia's economy and are often utilized when a more nuanced tool and result is needed and/or desired (versus prohibiting virtually all transactions with a party via designation).

On the U.S. side, while the 2014 sectoral sanctions on Russia focused on restricting certain debt and, to a lesser extent, equity transactions for targeted entities in the financial, energy and defense sectors, as well as certain Russian energy projects, OFAC has broad discretion in terms of what prohibitions could be imposed via sectoral sanctions (whether an expansion of the current prohibitions or targeting of additional parties under these existing sectoral sanctions authorities, or the imposition of entirely new sectoral sanctions, likely through the issuance of additional "Directives"). For example, if the United States determines that the imposition of blocking sanctions on certain large Russian financial institutions or the operator of the Nord Stream 2 pipeline is not desirable (from a collateral impact standpoint), but it wishes to target these parties, it could impose targeted sectoral sanctions that restrict some meaningful types of dealings or activities involving these parties without prohibiting dealings across the board. As is the case with blocking sanctions, OFAC could further fine-tune the scope and impact of these sanctions via the issuance of licenses, if desired.

Similarly, the European Union and United Kingdom could impose trade restrictions targeting the export, supply, sale, transfer, import, purchase or transportation of certain products, as well as the provision of related technical assistance, financing or brokering services. Trade restrictions could target key Russian sectors, including industrials, chemicals, metals, technology, insurance and energy. Measures could apply generally to all Russian entities or end-users or be targeted at particular Russian entities (or the Russian government), or otherwise restrict the participation in, or provision of, services to a wider category of energy projects. Licenses may provide a route for some business continuity. Whether the European Union and the United Kingdom will opt for any sanctions that could affect Russia's energy exports given, in particular, the European Union's reliance on such exports remains unclear, but U.S. efforts to secure gas supplies from alternative sources is clearly aimed at facilitating the European Union and United Kingdom to do so. Recent statements of EU officials appear to indicate that this option remains on the table.

The European Union and United Kingdom could also utilize their capital markets to issue targeted sanctions, for instance by prohibiting EU/U.K. persons from dealing in transferable securities or money-market instruments issued by a larger number of Russian entities (or the Russian government). Amendments to existing loans and credit restrictions to target additional entities or shorten maturity limits are also a more accessible option for the European Union and United Kingdom, relative to the imposition of full blocking sanctions.

3. Nord Stream 2 Pipeline

As discussed above, the controversial Nord Stream 2 pipeline between Russia and Germany could feature in any sanctions package, with the possibility of such action appearing to increase over the past week. This could take the form of blocking sanctions on Swiss-based Nord Stream 2 AG (NS2AG), the current operating company of the pipeline, as well as key executives of NS2AG, which the Biden-Harris administration has previously waived in deference to the stated energy supply concerns of the U.S. government's European allies. U.S., EU, and U.K. authorities could also impose more targeted sectoral sanctions on NS2AG, if comprehensive blocking measures are determined to be problematic. While the use of sanctions on NS2AG may be complicated by European energy-security concerns and other factors, and, historically, the project has raised significant political tensions with Europe, in the past several days, German, French and Austrian officials, among others, have joined U.K. officials in highlighting the potential for this option to be imposed if Russia invades Ukraine. Notably, Germany has indicated that any further aggression in Ukraine could result in termination of the regulatory approval needed to complete the pipeline.

4. Revised or New Restrictions on Russian Sovereign Debt

Based on recent statements of officials, another area of substantial focus is on the potential for expanded or additional sanctions targeting Russian sovereign debt. U.S. financial institutions are currently prohibited from participating in the primary market for certain Russian sovereign debt (excluding debt that was issued prior to the imposition of these sanctions). Reportedly, the United States is seriously considering an expansion of these sanctions, which could include newly targeting secondary market transactions in Russian sovereign debt (the Menendez/Meeks bill advocates for this) or, potentially, expanding the restrictions to new entities, such as certain state-owned entities. Alternatively, the United States could impose new restrictions to include dealings in existing Russian sovereign debt trading in the market, perhaps with a grandfathering provision allowing for the sale of such debt over time or, as was the case in the Venezuela sanctions program, accompanied by a license allowing certain transactions involving existing sovereign debt to continue. The European Union and United Kingdom could also introduce broader financial restrictions prohibiting EU/U.K. persons from dealing in Russian sovereign debt or debt (or equity) issued by state-owned entities, though any such measures would likely be limited to securities or instruments issued after the implementation of the sanctions.

5. SWIFT

There has been significant discussion in the press regarding whether the United States and its allies (principally the European Union) could impose—or threaten—sanctions that effectively block Russian banks' access to the Society for Worldwide

Interbank Financial Telecommunication (SWIFT) messaging system, or use SWIFT for U.S. dollar denominated transactions. Such sanctions could effectively exclude Russia, or even just a limited number of major Russian banks, from the global financial system, with potentially far-reaching impacts on global markets. Although Russia has already developed its own financial messaging system to provide an alternative to SWIFT, it is mainly used by Russian banks domestically and has significant practical limitations, including only having a small number of financial institutions as members (contrasted with SWIFT's 11,000+ institutions), apparent limitation of operations to weekday business hours and other limitations that could be significant impediments to use in significant cross-border transactions.

While this option was apparently included as a part of earlier discussions, U.S. officials have reportedly recently communicated that this option is not currently being considered. Such measures present an apparent risk of collateral harm to U.S., EU and U.K. economic interests and global financial markets, and could incentivize Russia (and potentially other countries concerned about the reach of U.S. sanctions) to design messaging and payment facilitation systems entirely outside the reach of U.S. jurisdiction as alternatives, thereby reducing U.S. visibility into underlying transactions. Moreover, it appears unlikely that there will be sufficient political will among EU member states to support sanctions action via SWIFT, which is a Belgian-based cooperative.

B. Possible New and Novel Export Controls Targeting Strategic Russian Sectors or Entities

In addition to financial sanctions, the U.S. government is likely to implement established and novel export controls to damage strategic Russian industries, potentially including aerospace, maritime, oil and gas, information technology, telecommunications and high-tech areas, such as those related to artificial intelligence and quantum computing.

1. Amending Established U.S. Export Controls

In the event that Russia engages in a military incursion into Ukraine, Russia would likely be moved to licensing Country Group E in the Export Administration Regulations (EAR), which is now the Country Group for Iran, North Korea, Syria and Cuba. This would mean that unilaterally (i.e., U.S.-only) controlled items—referred to in the EAR as items controlled for "Anti-Terrorism" (AT) reasons—would become controlled for export to Russia if they are U.S.-origin or sent from the United States. Such items do not now require a license for export to Russia unless there is knowledge that they are for a military end-use or a military end-user. With the expected rule change, such AT-only items would likely require a license for any end-user in Russia. The most common AT-only items are basic semiconductors and electronics, consumer software with basic encryption, and civil aircraft parts and related technology. The list of such unilaterally controlled items is lengthy and can be identified in the EAR's Commerce Control List as items with a "9" in the middle of their Export Control Classification Number (ECCN).

Another impact of this change would be that many non-U.S.-origin commodities, software and technologies outside the United States would become subject to EAR licensing requirements and Russia-related re-export prohibitions. Under current rules, many types of foreign-origin items with more than 25 percent of U.S.-origin controlled content require a license if destined to Russia from outside the United

States. The “controlled” content in this context is the more sensitive “dual-use” items that are identified in the multilateral export control regimes, which include “national security” controlled items. If Russia is moved to Country Group E, then foreign-made items with more than 10 percent of U.S.-origin AT-only content would become subject to the EAR and the Russia-related prohibitions. Most companies outside the United States that ship to Russia have not likely calculated whether their non-U.S.-origin products contain more than 10 percent U.S.-origin AT-only content because it would not have resulted in any additional license requirements. Thus, if the rule is changed, those responsible for compliance programs will need to scramble to reclassify the status of their non-U.S.-origin items to determine if they are subject to the EAR based on any U.S.-origin content.

The other likely change would be a more formal denial policy for licensing exports of dual-use items to Russia for commercial applications. There is already an embargo on the export to Russia of items that are bespoke for military applications or dual-use items destined for a military end-use. The impact on the licensing policies for space-related or safety-of-flight-related exports and re-exports to Russia is unknown. Such exports have been carved out of other embargo programs in the past.

2. Using Novel Extraterritorial Export Controls – The Foreign-Produced Direct Product Rule

In August 2020, the Trump administration created novel extraterritorial export control rules that subjected non-U.S.-origin commercial items outside the United States to U.S. export controls if they were designed with certain types of U.S.-origin software, or produced with certain types of tools or equipment. If such items are destined to a Huawei company, or for incorporation into an item Huawei had ordered, or to anyone else when Huawei is a party to the transaction, then a license is required—and generally denied. This “foreign-produced direct product rule” effectively subjected every semiconductor and many other types of electronic items on the planet to U.S. export controls given the ubiquity of the types of software and equipment used to make them. In other words, the U.S. government leveraged the ubiquity of U.S. software and tools as a jurisdictional hook to subject non-U.S.-made commercial items that were not otherwise subject to export controls to be subject to U.S. export controls.

Senior U.S. government officials have said that they are considering using this novel extraterritorial jurisdictional tool to apply to the shipment of non-U.S. made items outside the United States to all of Russia, to specific sectors in Russia or to specific entities in Russia. They have made clear that no decisions have been reached on what the scope of any such controls would likely be. Regardless of the scope chosen, the impact of this rule on non-U.S. origin electronic items and other types of items could be significant given the use worldwide of US-origin software, tools and other types of covered equipment to design and produce items. If the rule is scoped to apply to specific sectors of the Russian economy, it could cross-reference U.S. Harmonized Tariff Schedule (HTS) code definitions of items to define prohibitions on exports to entities that are not added to the Entity List. The U.S. government cross-referenced HTS codes to describe the scope of new export controls after the 2014 invasion on various types of items used in connection with the exploration or production of oil or gas in Russian deepwater or Arctic offshore locations or shale formations in Russia.

3. EU and U.K. Export Control Issues

From an EU or U.K. export control perspective, authorities could subject Russia-related license applications for the export, transfer or brokering of dual-use items (including goods, software and technology) to far greater scrutiny. Both the United Kingdom and individual EU member states could also adopt national controls on non-listed items. By making changes to their existing sanctions frameworks, the European and United Kingdom could limit the sale, supply, transfer, export or making available—directly or indirectly—of dual-use items (as well as technical assistance, financing and brokering services, etc.) to, or for use by, certain Russian entities (e.g., by amending the entities within the EU's Annex IV or U.K.'s Schedule 4). Differences in terminology between the EU and U.K. sanctions regimes post-Brexit causes the scope of these restrictions to differ, so we recommend companies consider them separately.

II. Recommendations and Risk Mitigation

U.S. and non-U.S. companies have an opportunity at this time to proactively assess their exposure to potential new sanctions and export controls, as new restrictions may be imposed on Russia with little further warning, and with potentially limited—or without any—"grandfathering" or "grace period" provisions. Such preparation can include a number of actions, including:

- Assess direct and indirect exposure to Russia, including Russian entities and financial institutions, as well as entities with Russian ownership, and/or counterparties who themselves have exposure to, or business activities in or involving, Russia or Russian entities.
  - Depending on the nature and scope of the measures, commercial arrangements may need to be ceased or adjusted to enable business continuity in compliance with sanctions.
  - Identify counterparties or contracts that might be affected, as well as the nature of your engagement (e.g., the nature of goods or services bought or sold; the involvement of U.S. persons or dollars) to better gauge sanctions and export controls risks.
  - If known touchpoints to Russia are identified, consider reviewing commercial agreements to assess (i) contractual rights in case of a change to a sanctions regime (whether under force majeure, illegality or excusal, or termination clauses); (ii) the nature of payment terms and any contractual rights to request amendment to terms (note: this option may only be available pre-sanctions); and (iii) the availability of pre-payment options.
  - Analyze investment portfolios to identify exposure to securities or other instruments issued by Russian entities or by entities owned or controlled by prominent Russian individuals or entities (measures imposed could materially impact the ability to hold or sell such instruments). Consider also any investments in U.S. or non-U.S. companies that themselves have exposure to Russia, including the presence of significant Russian investors.
- Determine to which sanctions and export control regimes your particular business is subject (i.e., consider locations where your business has entities and operates; currencies and banking systems utilized; the source of any goods, technology or software used; and the nationalities of executives and board members).

- Revisit any relevant business or management approval processes, and related recusal frameworks, to identify any U.S., EU or U.K. persons who might need to recuse themselves in case of new sanctions, and identify alternative approvers. Companies may be able to alter procedures pre-sanctions, but doing so after sanctions implementation to enable an otherwise prohibited transaction could constitute prohibited facilitation or circumvention.
- Assess what would need to be done if your business was required to shut down, or limit meaningful aspects of, Russia-related trade immediately in the event no “grace period” is given.

III. Conclusions

The current situation involving Russia is rapidly evolving. Numerous options are “on the table” for coordinated action against Russia by the U.S., EU, and U.K. governments if Russian forces proceed across the border of Ukraine. Even in a scenario where Russian troops do not proceed further, it is now foreseeable that the United States and its allies may implement new punitive measures to impose costs on Russia in connection with the current international crisis. In the event that significant new sanctions are imposed on Russia, companies should also consider, and be prepared for, the possibility of Russian countermeasures that could impact Western companies’ ability to engage in business involving Russia.

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