

## Trump Administration Sanctions Chinese Entity and its Director in First Imposition of Secondary Sanctions under Section 231 of CAATSA

September 25, 2018

### Key Points

- On September 20, 2018, for the first time, the Trump administration imposed sanctions on a non-U.S. entity and its director for engaging in “significant transactions” with a Russian defense sector company included on the State Department’s LSP. The State Department also added an additional 33 persons engaged in the Russian defense and intelligence sectors to the LSP.
- While the State Department emphasized that the secondary sanctions were targeting the Russian supplier, rather than the Chinese acquirer, the actions taken emphasize the extraterritorial scope of U.S. sanctions and their potential impact on non-U.S. companies and individuals.
- Non-U.S. persons engaging in activities, particularly with Russia, that are subject to U.S. secondary sanctions should take note of the administration’s actions and assess the secondary sanctions risk associated with their activity.

### Background

President Trump signed the Countering America’s Adversaries Through Sanctions Act (CAATSA) into law on August 2, 2017. Section 231 of this law requires the imposition of sanctions on anyone “that the President determines knowingly . . . engages in a **significant transaction** with a person that is part of, or operates for or on behalf of, the **defense or intelligence sectors of the Government of the Russian Federation**, including the Main Intelligence Agency of the General Staff of the Armed Forces of the Russian Federation or the Federal Security Service of the Russian Federation.” (emphasis added). On October 27, 2017, the State Department issued an initial List of Specified Persons (LSP) of 39 entities and individuals. Our October 2017 [client alert](#) describes that action in more detail.

Although the law provided for mandatory sanctions “[o]n or after the date that is 180 days after the date of the enactment of [CAATSA]” (January 29, 2018), the State

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Department did not impose any sanctions by that date, **explaining** that January 29 “was not a deadline to impose sanctions; it was actually a start date.” Instead, the State Department repeatedly outlined its strategy of deterring allies from buying Russian arms or engaging in significant transactions with the listed entities, rather than sanctioning them. Several members of Congress **disagreed** with this approach to implementing Section 231, noting that it “fell short of sending a strong signal that the U.S. is fully prepared to impose these secondary sanctions in the event of a violation.”

In recent testimony before the Senate Banking Committee, Dr. Christopher A. Ford, Assistant Secretary of State for International Security and Nonproliferation, **discussed** the State Department’s approach in enforcing this section. On the issue of what is a “significant transaction,” Dr. Ford elaborated on the explanations provided since CAATSA came into effect, stating that the State Department is “not usually concerned with Russia’s mere provision of spare parts or its maintenance of military equipment that another country already possesses.” Instead, the concerns begin “where and when something more consequential occurs – something such as a major transfer of foreign funds to the Russian defense sector, for instance, or a new shipment of equipment representing a qualitative upgrade in capability, such as an S-400.” Dr. Ford added that just talking about or announcing a Russian arms deal will not be significant; rather, the problem arises “when new Russian equipment starts to show up or perhaps when large sums of money begin to change hands.” This explanation of a “significant transaction” was reinforced once again by the State Department in its September 20 press briefing.

## Sanctions Imposed Against Two Chinese Persons for Engaging in Significant Transactions with Rosoboronexport

In the first imposition of secondary sanctions under Section 231 of CAATSA, on September 20, the Office of Foreign Assets Control (OFAC) and the State Department imposed sanctions on Equipment Development Department (EDD), formerly known as the General Armaments Department, a Chinese entity, and its director, Li Shangfu for “engaging in significant transactions” with Rosoboronexport, Russia’s main arms export entity, which has been on the LSP since October 27, 2017. According to the State Department **fact sheet**, these “significant transactions” involved Russia’s transfer to China of “ten Su-35 combat aircraft in December 2017 and an initial batch of S-400 (a.k.a. SA-21) surface-to-air missile system-related equipment in 2018.” The State Department also noted that both transactions resulted from deals negotiated between EDD and Rosoboronexport before the implementation of CAATSA on August 2, 2017.

Pursuant to CAATSA Section 231, OFAC added both EDD and Li Shangfu to its Specially Designated Nationals and Blocked Persons (SDN) List, meaning that U.S. persons are generally prohibited from engaging in transactions with such persons and their property and interests in property (including entities owned 50 percent or more in the aggregate, directly or indirectly, by these SDNs), and non-U.S. persons may be sanctioned for engaging in “significant transactions” with these newly listed persons, pursuant to CAATSA Section 228. The State Department was required to issue at least five sanctions from a menu of 12 sanctions options provided in CAATSA Section 235 and did so on September 20, resulting in the following actions (in addition to the OFAC sanctions described above): (i) the denial of export licensing for EDD, (ii)

prohibitions on foreign exchange transactions for both EDD and Li Shangfu, (iii) prohibition on transactions with the U.S. financial system for both EDD and Li Shangfu, and (iv) the denial of a visa for EDD's director, Li Shangfu.

The State Department emphasized that these actions were not intended to undermine the military capabilities or combat readiness of any country, but rather “to impose costs on Russia in response to its interference in the United States election process, its unacceptable behavior in eastern Ukraine, and other malign activities.” In its press briefing, the State Department emphasized that its enforcement of Section 231 is an “ongoing process” and that “the ultimate goal of this legislation is to prevent revenue from flowing to the Russian Government.” The State Department officials noted that CAATSA has been used to deter arms transfers by Russia and that it “had some good results in probably preventing the occurrence of several billion dollars’ worth of transfers simply by having the availability of this sanctions tool in our pocket.”

The response from China and Russia to these sanctions was defiant. A spokesman for China’s foreign ministry **demand**ed the removal of the sanctions, “otherwise, the U.S. must bear the consequences.” A Chinese Foreign Ministry spokesman stated that the sanctions “seriously violated the basic norms of international relations.” Russia’s Foreign Minister called the measures “another manifestation of unfair competition,” and the Russian deputy foreign minister said the sanctions are futile and have “turned into a kind of national entertainment” for the U.S. government.

## **Addition of 33 Entities and Individuals to CAATSA Section 231(d) Defense and Intelligence Sector List of Specified Persons**

As noted above, also on September 20, the Department of State added six entities and 27 individuals to the LSP (see full list [here](#)) for being a “part of, or operating for or on behalf of, the defense or intelligence sectors of the Government of the Russian Federation,” increasing the total number of persons on this list to 72. Any person that knowingly engages in a “significant transaction” with any of these persons is subject to mandatory sanctions under CAATSA Section 231. As a senior administration official **expl**ained, “[n]othing specifically happens to someone by virtue of being on [this] list.”

It is worth noting that, according to **Bloomberg**, 25 of the 33 entities and individuals added to the LSP were indicted by Special Counsel Robert Mueller in February and July 2018.

Along with the additions to the LSP, the State Department also published a new **FAQ** confirming that significant transactions with non-listed subsidiaries of persons specified on the LSP (as well as other persons not listed on the LSP) “are not currently the focus of our Section 231 implementation efforts.”

Further, in its press briefing, the State Department affirmed its October 2017 guidance on what is a “significant transaction,” explaining that it will continue to employ a multifactor, totality of the facts and circumstances test and weigh various factors (e.g., the significance of the transaction to U.S. national security and foreign policy interests, the nature and magnitude of the transaction and the relation and significance of the transaction to the defense or intelligence sector of the Russian government) on a

case-by-case basis. As before, transactions for goods and services with purely civilian end-uses and/or civilian end-users will generally weigh against a determination of significance. In addition, State Department officials repeated in the press briefing, as Dr. Ford alluded to in August, that the State Department is “not **targeting** things such as simply the provision of spare parts and maintenance,” but rather is focusing on the “bigger ticket items” such as a “large shipment of new, fancy, qualitatively significant stuff.”

## Executive Order Authorizing the Implementation of Certain CAATSA Sanctions

Just hours before the additions to the LSP and the sanctions designations pursuant to Section 231 were announced, the President issued an **executive order** that authorizes the implementation of certain secondary sanctions set forth in CAATSA, including secondary sanctions under Section 231 of CAATSA. The executive order delegates authority to relevant agencies, including the Department of the Treasury and Department of State, to implement “menu-based” secondary sanctions against persons meeting certain criteria described in CAATSA.

Specifically, the executive order implements CAATSA secondary sanctions that target persons for making significant investments in “special Russian crude oil projects” (e.g., Russian deepwater, Arctic offshore and shale projects) (Ukraine Freedom Support Act Section 4(b), as modified by CAATSA Section 225); providing certain types of support or financial services related to cyber interference activities (CAATSA Section 224(a)(2) and (a)(3)); engaging in significant transactions with the intelligence or defense sectors of Russia (CAATSA Section 231); providing certain goods, services, technology, information or support for, or investments in, the development of energy export pipelines in Russia (CAATSA Section 232(a)); and engaging in certain investments in or the facilitation of privatization of state-owned assets by Russia (CAATSA Section 233(a)). The September 20 designations by the State Department and OFAC described above were carried out under the authorizations provided in the Executive Order with respect to the Russian intelligence and defense sectors (CAATSA Section 231).

## Analysis and Outlook

The administration’s actions on September 20 represented the **first** use of CAATSA to sanction non-U.S. persons that have engaged in “significant transactions” with Russia’s military/intelligence sectors. The actions signal that the U.S. government is scrutinizing transactions between non-U.S. companies and Russian defense and intelligence entities listed on the LSP. Companies engaged in activities with these listed persons should conduct a risk assessment to determine whether such activities could expose them to secondary sanctions.

More broadly, the September 20 actions may also signal that, after facing months of criticism from both Republicans and Democrats in Congress for its failure to implement CAATSA, the administration is prepared to impose other secondary sanctions under CAATSA. With Congress currently considering several significant pieces of legislation that would impose stronger sanctions on Russia—including the Defending Elections from Threats by Establishing Redlines Act of 2018 (**DETER Act**) and the Defending

American Security from Kremlin Aggression Act of 2018 (**DASKAA**)—it remains to be seen whether these new CAATSA Section 231 actions, along with the issuance of **Executive Order 13848** on September 12 that authorizes the sanctioning of foreign persons who interfere in a U.S. federal election, will be sufficient to dissuade Congress from further action.