

International Trade Alert

January 22, 2018

Key Points

- The next significant Countering America's Adversaries Through Sanctions Act (CAATSA)-related deadline for the Trump administration is January 29, 2018, when it must submit reports to Congress on "oligarchs and parastatal entities of the Russian Federation" and the "effects of expanding sanctions to include sovereign debt and derivative products."
- It is currently uncertain what criteria the Trump administration will use to develop the reports, what the reports will look like when they reach Congress in late January and whether they will be made public.
- With respect to other CAATSA provisions, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) and the U.S. Department of State previously issued an amended directive and guidance in late 2017 that implemented and clarified new sanctions on Russia pursuant to CAATSA.
- OFAC expanded Directive 4 of Executive Order 13662 to impose restrictions on deepwater, Arctic offshore and shale oil projects worldwide that are initiated on or after January 29, 2018, in which entities subject to Directive 4 have (i) at least a 33 percent ownership interest or (ii) ownership of a majority of the voting interests.

Implementing CAATSA Sanctions on Russia: Approaching Deadlines for "Oligarchs" and "Sovereign Debt" Reports and Recap of Latest Developments

Under Section 241 of CAATSA, the Secretary of the Treasury, in consultation with the Director of National Intelligence and the Secretary of State, is required to submit a report to Congress by January 29, 2018, regarding "senior foreign political figures and oligarchs in the Russian Federation" and "Russian parastatal entities."

We understand that there is ongoing internal debate within relevant U.S. agencies regarding how broad the list of "oligarchs" included in the report should be. While some have argued for the compilation of a large list of individuals to be included in the report, other influential observers have suggested that the list

should be kept small, with a focus on “Kremlin Cronies,” chosen because of their connections to and interactions with President Putin or other high-ranking officials.

For example, a recent [article](#) co-authored by Ambassador Daniel Fried, who served as coordinator of sanctions policy at the U.S. State Department until February 2017, has recommended that this report focus on a targeted set of limited criteria, including (i) the closeness of an individual to the Russian leadership, “measured by his or her involvement in planning, ordering, preparing, financing, executing, or otherwise supporting” certain “aggressive, corrupt, or criminal actions;” (ii) whether the “person’s fortune has been made through corrupt commercial operations with the Putin regime for the sake of personal gain;” and (iii) whether the “person has held assets for Putin in what appears to be a corrupt fashion.” However, it is currently uncertain what criteria the Trump administration will use to determine persons to include in the CAATSA Section 241 report, what the report will look like when it reaches Congress in late January and whether it will be made public.

Additionally, under Section 242 of CAATSA, the Secretary of the Treasury, in consultation with the Secretary of State and the Director of National Intelligence, is required to submit a report to Congress by January 29, 2018, describing in detail the potential effects of expanding existing U.S. sanctions that prohibit transactions or dealings by U.S. persons in “new debt” of longer than 14 days’ maturity of sanctioned Russian financial institutions to also target sovereign debt issued by the Russian Federation and “the full range of derivative products.” As with the “oligarchs” report described above, this report on sovereign debt will not automatically impose any new sanctions, but it could be a precursor to future sanctions targeting Russian sovereign debt, depending on how U.S.-Russia relations evolve.

Expansion of Directive 4 to Cover New Deepwater, Arctic Offshore and Shale Projects Worldwide

With respect to other CAATSA provisions, OFAC has amended [Directive 4 of Executive Order 13662](#) to prohibit U.S. persons from providing, exporting or re-exporting, directly or indirectly, goods, services (except for financial services) or technology in support of exploration or production for deepwater, Arctic offshore or shale projects (unconventional projects) **worldwide** that involve Russian companies subject to Directive 4 that meet all three of the following criteria:

- The project was **initiated** on or after January 29, 2018.
- The project has the potential to produce oil **in any location**.
- Any entity subject to Directive 4¹ has either (i) a 33 percent or greater ownership interest or (ii) ownership of a majority of the voting interests in the project.

OFAC released several FAQs providing further guidance in conjunction with the implementation of this expansion of Directive 4 sanctions restrictions. Of particular significance:

- [FAQ #536](#) clarifies that a project is “initiated” when “a government or any of its political subdivisions, agencies, or instrumentalities (including any entity owned or controlled directly or

indirectly by any of the foregoing) formally grants exploration, development, or production rights to any party.”

- **FAQ #538** provides that OFAC will aggregate ownership stakes of all entities subject to Directive 4 in a particular project to determine whether the ownership or voting interest thresholds for Directive 4 sanctions are met. For example, if two entities (or their subsidiaries) designated under Directive 4 each hold a 20 percent ownership interest in a deepwater oil project anywhere in the world that is initiated on or after January 29, 2018, or together own a majority of the voting interests in such project, then the prohibitions of Directive 4 will apply to the project.

Importantly, the original Directive 4 prohibition related to deepwater, Arctic offshore and shale projects in Russia, which was originally imposed on September 12, 2014, remains in effect. Under this provision, U.S. persons are prohibited from providing, exporting or re-exporting goods, services (except financial services) or technology in support of exploration or production for deepwater, Arctic offshore or shale projects (regardless of when they were initiated) “that have the potential to produce oil in the Russian Federation, or in a maritime area claimed by the Russian Federation and extending from its territory, and that involve” a person subject to Directive 4.

Directive 4’s newly expanded reach increases the need for companies with interests in the global energy sector to evaluate how these sanctions may impact their business activities. As a preliminary matter, companies should adopt enhanced due diligence and compliance safeguards to ensure that they understand (i) whether their activities intersect with unconventional projects; (ii) whether parties subject to Directive 4 may be involved; and, if so, (iii) the ownership and control structure of such projects, as well as the dates of initiation. Moreover, exporters and providers of goods or services involving unconventional projects should consider additional safeguards, including contractual terms and conditions or end-use certifications, to ensure compliance with Directive 4.

State Department Guidance on Section 225: Mandatory Secondary Sanctions for Significant Investments in Deepwater, Arctic Offshore or Shale Projects in Russia

On October 31, 2017, the State Department released **public guidance** on Section 225 of CAATSA, which requires the President to impose sanctions on “foreign persons” who knowingly, on or after September 1, 2017, make a “significant investment” in deepwater, Arctic offshore or shale oil projects in Russia (absent a presidential determination that such action is not in the U.S. national interest).

This guidance states that, in considering whether or not an investment qualifies as “significant” under these provisions, the State Department “will consider the totality of the facts and circumstances surrounding the investment and weigh various factors on a case-by-case basis,” including the following factors:

- the significance of the transaction to U.S. national security and foreign policy interests, in particular, where the transaction has a significant adverse impact on such interests

- the nature and magnitude of the investment, including the size of the investment relative to the project's overall capitalization
- the relation and significance of the investment to the Russian energy sector.

Among other clarifications, the guidance also states that an investment in these types of projects would not be considered "significant" if a U.S. person would not require a specific license from OFAC to "make or participate in" the investment. The guidance also clarifies that the term "investment" can include "arrangements where goods or services are provided in exchange for equity in an enterprise or rights to a share of the revenue or profits of an enterprise."

State Department Guidance on Section 232: Discretionary Secondary Sanctions Related to Development of Russian Energy Export Pipelines

The State Department also issued [guidance](#) on Section 232 of CAATSA, which provides the President with discretionary authority to impose sanctions related to Russian energy export pipelines. This provision has raised concerns in Europe due to its potential negative impacts on energy export pipelines from Russia to Europe. Specifically, Section 232 of CAATSA permits, but does not require, the President to impose sanctions on persons who knowingly (i) make an investment that "directly and significantly contributes to the enhancement of the ability of the Russian Federation to construct energy export pipelines;" or (ii) sell, lease or provide to Russia, for the construction of Russian energy export pipelines, goods, services, technology, information or support that "could directly and significantly facilitate the maintenance or expansion of the construction, modernization, or repair of energy pipelines," provided that, in either case, the value of such investments, goods, services, technology or information exceed specified value thresholds.

The latest State Department guidance elaborates on three key aspects of these discretionary sanctions:

- These sanctions focus on energy export pipelines that "(1) originate in the Russian Federation, and (2) transport hydrocarbons across an international land or maritime border for delivery to another country." However, "[p]ipelines that originate outside the Russian Federation and transit through the territory of the Russian Federation would not be the focus of implementation."
- The focus of these sanctions is on export pipeline projects initiated on or after August 2, 2017. For purposes of Section 232, a project is considered to be "initiated" when a contract for the project is signed. The guidance also clarifies that "investments and loan agreements made prior to August 2, 2017, would not be subject to Section 232 sanctions" and that these sanctions "would not target investments or other activities related to the standard repair and maintenance of pipelines in existence on, and capable of transporting commercial quantities of hydrocarbons as of, August 2, 2017."
- Furthermore, the guidance provides that these discretionary sanctions will be focused on any person who knowingly "(1) made an investment that ...directly and significantly enhances the ability of the Russian Federation to construct energy export pipeline projects . . . or (2) sells,

leases, or provides to the Russian Federation goods or services . . . that directly and significantly facilitate the expansion, construction, or modernization of such energy export pipelines by the Russian Federation.”

OFAC Guidance on Section 223(a): Discretionary Secondary Sanctions Related to the Railway or Metals and Mining Sectors

OFAC also issued guidance on Section 223(a), which provides OFAC with discretionary authority to impose sectoral sanctions on state-owned entities operating in the railway or metals and mining sectors of the Russian economy, pursuant to Executive Order 13662.

In [FAQ #539](#), OFAC states that, “[w]hile sanctions may be imposed on potential targets in any sector of the economy of the Russian Federation in the future, maintaining unity with partners on sanctions implemented with respect to the Russian Federation is important to the U.S. government.” This guidance, while not limiting the possibility of unilateral U.S. action in the future, suggests that the Trump administration and OFAC are not currently contemplating imposing sectoral sanctions against the Russian state-owned railway, metals or mining sectors and would consult with EU allies before taking such action.

OFAC Guidance on Section 226: Mandatory Secondary Sanctions Targeting Foreign Financial Institutions

Section 226 of CAATSA requires the President to prohibit the use of correspondent accounts in the United States by “foreign financial institutions” (FFIs) that knowingly facilitate “significant transactions” involving “significant investment” in Russian deepwater, Arctic offshore or shale projects, or certain defense-related transactions, as well as significant financial transactions on behalf of any Russian person included on the Specially Designated Nationals and Blocked Persons List (“SDN List”) maintained by OFAC. Previously, these sanctions were discretionary. [FAQ #541](#) further states that FFIs “will not be subject to sanctions” under this provision “solely on the basis of knowingly facilitating significant financial transactions on behalf of persons listed on OFAC’s Sectoral Sanctions Identifications List”

In [FAQ #542](#), OFAC indicates that, for purposes of determining whether transactions are “significant,” it will consider the following nonexhaustive set of factors: “(1) the size, number, and frequency of the transaction(s); (2) the nature of the transaction(s); (3) the level of awareness of management and whether the transaction(s) are part of a pattern of conduct; (4) the nexus between the transaction(s) and a blocked person; (5) the impact of the transaction(s) on statutory objectives; (6) whether the transaction(s) involve deceptive practices; and (7) such other factors as the Secretary of the Treasury deems relevant on a case-by-case basis.”

OFAC Guidance on Section 228: Mandatory Secondary Sanctions Targeting Transactions with “Foreign Sanctions Evaders”

Among other measures, Section 228 of CAATSA generally requires the President to impose sanctions on any foreign person who “knowingly . . . facilitates a significant transaction or transactions, including

deceptive or structured transactions, for or on behalf of” persons subject to U.S. sanctions against Russia, subject to certain waiver authority.

In [FAQ #545](#), OFAC states that, in order to be considered a “significant” transaction that could trigger these secondary sanctions, a transaction with a person subject to sectoral sanctions (as opposed to a person who is an SDN) must “also involve deceptive practices (i.e., attempts to obscure or conceal the actual parties or true nature of the transactions(s), or to evade sanctions).

Furthermore, this FAQ states that, when determining whether a transaction is a “significant transaction,” OFAC will consider the list of seven broad factors listed above in relation to Section 226, as well as other factors that it deems relevant in specific cases.

OFAC Guidance on Section 233: Mandatory Secondary Sanctions Targeting Privatization of Russian State-Owned Assets

Section 233 of CAATSA requires the President to impose sanctions on any person who, “with actual knowledge,” makes or “facilitates” an investment of \$10 million or more (or a combination of investments, each of \$1 million or more and totaling \$10 million or more during any 12-month period) that “directly and significantly contribute to the ability” of Russia to privatize state-owned assets in a “manner that unjustly benefits” officials of the Russian government or “close associates” or family members of those officials. As discussed in a previous [client alert](#) following the enactment of CAATSA, this measure is broadly written and is subject to discretionary application by OFAC. Accordingly, transactions associated with the privatization of Russian assets should be evaluated carefully to ensure that they do not provide exposure to secondary sanctions under CAATSA.

[FAQ #540](#) defines several important terms found in Section 233 of CAATSA, including:

- “Investment” is interpreted broadly to cover a “transaction that constitutes a commitment or contribution of funds or other assets or a loan or other extension of credit to an enterprise.”
- “Unjustly benefits” is also interpreted broadly to cover activities including “public corruption that result[s] in any direct or indirect advantage, value, or gain, whether the benefit is tangible or intangible, by officials of the government of the Russian Federation, or their close associates or family members. Such public corruption could include, among other things, the misuse of Russian public assets or the misuse of public authority.”
- The term “close associate” of an official of the government of the Russian Federation is interpreted to cover “a person who is widely or publicly known, or is actually known by the relevant person engaging in the conduct in question, to maintain a close relationship with that official.”
- The term “family member” of an official of the Government of the Russian Federation is interpreted to include “parents, spouses (current and former), extramarital partners, children, siblings, uncles, aunts, grandparents, grandchildren, first cousins, stepchildren, stepsiblings, parents-in-law, and spouses of any of the foregoing.”

Looking Ahead

The new sanctions measures mandated by CAATSA significantly increase the need for both U.S. and non-U.S. companies to ensure that their business activities do not expose them to sanctions enforcement risks, particularly with respect to activities intersecting with the Russian energy sector. Despite the guidance provided by OFAC and the State Department in recent months, key terms in CAATSA are broadly defined, allowing the agencies broad latitude to enforce particular sanctions measures. Adding to the complexity of ensuring compliance with Russia sanctions, U.S. relations with Russia remain fluid, and there are many variables that could affect the way in which U.S. sanctions against Russia evolve this year that are impossible to predict. U.S. and non-U.S. businesses engaging in business with Russia should continue to monitor Russia sanctions developments and potential Russian responses to any additional sanctions to determine their potential impact and take steps designed to ensure compliance.

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¹ Persons subject to Directive 4 include entities listed on the Sectoral Sanctions Identifications (SSI) List under Directive 4 and any entity that is 50 percent or more owned, directly or indirectly, by one or more such listed entities, either individually or in the aggregate.