



The EU's Russia Sanctions and the Year Ahead – Practical Tips For Businesses

European Union (EU) sanctions on Russia have evolved into a comprehensive and complex regime. They will likely remain relatively extensive in the year ahead.

On 15 January 2015, the European Parliament adopted a motion calling “*for the continuation of the current EU sanctions regime [...]*.”¹ A few days later, on 19 January 2015, the new EU High Representative for Foreign Affairs, Federica Mogherini confirmed that the EU would “*stay the course*” in relation to Russia.²

Indeed, in the event of a further destabilisation of Ukraine, the EU Parliament had even called for the EU “*to take up further restrictive measures and broaden their scope, by covering the nuclear sector and by limiting the ability of Russian entities to conduct international financial transactions.*”³

While Sigmar Gabriel, Germany's Vice-Chancellor stated that “*those who want it [tougher sanctions against Russia], provoke an even more dangerous situation for all of us in Europe*”⁴, the recent attack on Mariupol sparked fresh warnings from Germany of further enhanced EU measures. Politicians from Chancellor Merkel's CDU party were particularly outspoken on the issue: “*If the Russian government cannot show any progress towards de-escalating the situation, unfortunately we will have to talk about more stringent sanctions.*”⁵ Either way, it seems unlikely that the EU will lift its current sanctions regime against Russia any time soon. Companies will have to continue to comply with a complex and extensive regime which was significantly extended once again just before Christmas. This note provides (i) an overview of the measures currently in place and (ii) some additional guidance on practical problems businesses may face in seeking to comply with these measures.

¹ European Parliament resolution of 15 January 2015 on the situation in Ukraine (2014/2965(RSP), available at <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P8-TA-2015-0011>, para. 7.

² Remarks by High Representative/Vice-President Federica Mogherini at the press conference after the Foreign Affairs Council, 19 January 2015, available at http://www.eeas.europa.eu/statements-eeas/2015/150119_05_en.htm.

³ European Parliament resolution of 15 January 2015 on the situation in Ukraine (2014/2965(RSP), para. 7.

⁴ More Russia sanctions to provoke 'dangerous situation' in Europe – German vice-chancellor, Russia Today, 4 January 2015, available at <http://rt.com/news/219771-sanctions-russia-dangerous-germany/>.

⁵ Raketenangriff auf Mariupol: CDU und Grüne fordern neue Sanktionen gegen Russland, Der Spiegel, 25 January 2015, available at <http://www.spiegel.de/politik/ausland/mariupol-debatte-ueber-schaerfere-sanktionen-gegen-russland-a-1014900.html>.

The Status Quo: A Complex Regime

The EU sanctions architecture against Russia is currently built upon three separate elements, making this a complex set of rules with potentially far-reaching consequences for businesses. Put simply, the EU has put in place (i) “smart sanctions” against specified individuals and entities, (ii) restrictions targeting key sectors of the Russian economy (as listed below), and (iii) trade and investment restrictions severely undermining EU trade with the Crimea/Sevastopol region. The application of these differing restrictions to a company’s commercial operations can be challenging:

1. As at January 2015, **154 individuals and 28 entities were subject to an EU asset freeze and a prohibition (on EU third parties) to make available funds and economic resources** to these individuals and entities.⁶ In addition, these EU prohibitions also render illegal most commercial dealings with entities “owned” or “controlled”⁷ by the designated persons. While it is impossible to judge the precise impact of this rule, KPMG’s Forensic Team has recently found that “more than 200 individuals and companies” subject to EU and U.S. sanctions against Russia have an interest in more than 1,400 entities worldwide, which means that these entities, in turn, could potentially be caught by the EU prohibitions. KPMG stated that “*a number of the entities are located in the UK, Austria, Germany, Finland, Cyprus, Hong Kong, India and other jurisdictions – and would therefore not be obviously identifiable as being potentially sanctioned.*”⁸
2. **EU measures against key sectors of the Russian economy** restrict and/or prohibit:
 - the **access to EU capital markets** for five Russian state-owned banks⁹, three Russian providers of military goods¹⁰, and three Russian oil majors¹¹;
 - the **supply of dual-use items** to nine specific Russian entities¹² and the Russian military, including the provision of technical assistance, brokering, and other services, as well as financing and financial assistance, related to dual-use items;

⁶ Cf. Regulations (EU) No 208/2014 of 5 March 2014 and 269/2014 of 17 March 2014, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0208> and <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0269>, as amended.

⁷ Cf. EU Council, *Guidelines on implementation and evaluation of restrictive measures (sanctions) in the framework of the EU Common Foreign and Security Policy - new elements*, 30 April 2013, available at http://www.urm.lt/uploads/default/documents/uzienio_politika/tarptautiniu_sankciju_igyvendinimas/st09068_en13.pdf, pp. 3-4.

⁸ KPMG Switzerland, *International Sanctions against Russia: What Swiss businesses have to consider*, available at <http://blog.kpmg.ch/international-sanctions-against-russia-what-swiss-businesses-have-to-consider/>.

⁹ Cf. Annex III to Regulation (EU) No 833/2014 of 31 July 2014, available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2014_229_R_0001&from=EN, as amended by Regulation (EU) No 960/2014 of 8 September 2014, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0960&from=EN> and Regulation (EU) No 1290/2014 of 4 December 2014, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R1290&from=EN> (together, Regulation (EU) 833/2014, as amended): Sberbank, Gazprombank, VTB, Russian Agriculture Bank (Rosselkhozbank), and VEB.

¹⁰ Cf. Annex V to Regulation (EU) No 833/2014, as amended: OPK Oboronprom, United Aircraft Corporation, and Uralvagonzavod.

¹¹ Cf. Annex VI to Regulation (EU) No 833/2014, as amended: Rosneft, Transneft, and Gazprom Neft.

- the supply of certain services necessary for **deep water oil exploration and production, arctic oil exploration and production, or shale oil projects** in Russia¹³, while making certain technologies and equipment related to this sector subject to prior authorisation¹⁴; and
- the provision of **military goods**, related technical assistance, and financing to Russian end-users or for use in Russia.¹⁵

While commonly referred to as “sector-wide measures”, these restrictions and prohibitions are, in fact, relatively specific (at least where they relate to the access restrictions to EU capital markets and the Russian energy sector). That, in turn, often means that businesses have to consider very carefully whether their commercial operations, or specific transactions, in respect of Russia are caught by these “sector-wide measures”. Some national competent authorities, including in the UK and Germany have sought to counter-act uncertainty by providing FAQs, guidance notes, or even hotlines specific to trade restrictions on Russia.¹⁶ That said, companies may prefer to obtain external advice on specific transactions, given the thicket of rules and jurisdictions that may apply to a given transaction involving a Russia nexus (it should be noted that certain transactions may also have to be reviewed from a U.S. angle, in addition to the EU rules summarised in this Memo).

3. The EU has also legislated to significantly restrict EU trade with **Crimea and Sevastopol**. The measures include:
 - a general prohibition on the import into the EU of goods originating from Crimea and Sevastopol;¹⁷
 - a general ban on any investments, participation in joint ventures, and/or the provision of financing in Crimea or Sevastopol;¹⁸

¹² Cf. Annex IV to Regulation (EU) No 833/2014, as amended: (i) JSC Sirius (optoelectronics for civil and military purposes), (ii) OJSC Stankoinstrument (mechanical engineering for civil and military purposes), (iii) OAO JSC Chemcomposite (materials for civil and military purposes), (iv) JSC Kalashnikov (small arms), (v) JSC Tula Arms Plant (weapons systems), (vi) NPK Technologii Maschinostrojenija (ammunition), (vii) OAO Wysokototschnye Kompleksi (anti-aircraft and anti-tank systems), (viii) OAO Almaz Antey (state-owned enterprise; arms, ammunition, research), and (ix) OAO NPO Bazalt (state-owned enterprise, production of machinery for the production of arms and ammunition).

¹³ Cf. Article 3a of Regulation (EU) No 833/2014, as amended.

¹⁴ Cf. Article 3 of Regulation (EU) No 833/2014, as amended.

¹⁵ Cf. Article 4 of Regulation (EU) No 833/2014, as amended.

¹⁶ For example, the UK Department for Business, Innovation & Skills’ Guidance on EU sanctions against Russia: information for exporters, available at <https://www.gov.uk/government/publications/eu-sanctions-against-russia-information-for-exporters>, or Germany’s BAFA Merkblatt zum Außenwirtschaftsverkehr mit der Russischen Föderation, available at http://www.ausfuhrkontrolle.info/ausfuhrkontrolle/de/arbeitshilfen/merkblaetter/merkblatt_russland.pdf. In addition, BAFA has set up a hotline specifically to deal with companies’ queries on Germany’s/the EU’s Russia sanctions.

¹⁷ Cf. Article 2 of Regulation (EU) No 692/2014 of 23 June 2014, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0692&from=EN>.

¹⁸ Cf. Article 2a of Regulation (EU) No 692/2014, as amended by Regulation (EU) No 1351/2014 of 18 December 2014, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L..2014.365.01.0046.01.ENG>, (together, Regulation (EU) 692/2014, as amended).

- a list of embargoed goods and technologies, concerning the transport, telecommunications and energy sectors or the prospection, exploration and production of oil, gas and mineral resources;¹⁹
- an embargo to provide “technical assistance, or brokering, construction or engineering services directly relating to infrastructure in Crimea or Sevastopol” with respect to the transport, telecoms, infrastructure and natural resources sectors;²⁰ and
- restrictions with respect to the real estate and tourism sectors.²¹

The existence of separate rules for the Crimea/Sevastopol region in addition to the generally applicable “Russia sanctions” discussed above, introduces yet another layer of complexity to the equation, in particular for businesses that are active in “Russia”. Companies should be acutely aware, exactly where in Russia their activities take place and design their internal compliance infrastructure accordingly. It is noteworthy that this element to the EU sanctions regime on Russia was significantly extended on 18 December 2014.²²

Practical Considerations For Businesses

As a result of this multifaceted regime, businesses will need to remain vigilant and ensure continual compliance with potentially fast-changing rules. In particular, in-house legal teams need to be able to ensure compliance with the latest set of rules almost instantly. As an example, Germany grants companies a mere two-day grace period within which to implement EU restrictive measures.²³ Failure to comply may lead to fines, the prosecution of individuals and severe reputational damage. Indeed, businesses today are expected to have in place sophisticated compliance programs. This expectation stems not just from public authorities. Investors regularly make their investment conditional upon robust compliance standards being in place. Equally, lenders may require their creditors to ensure trade compliance measures are set up at third party target companies.

The moment a company discovers it has commercial dealings with a sanctioned counterparty, this throws up a number of issues. For instance, how should commercial agreements with blacklisted counterparties be treated? Where a company has entered into an agreement with a sanctioned entity before said entity was sanctioned, that company may be able to rely on so-called “grandfather” provisions. These provisions are typically available in the relevant EU Regulations.²⁴

Nevertheless, companies should be mindful that even where a transaction is legally possible, it may not be reputationally sensible. But even where a company wishes to cease dealings in order to comply with sanctions, this may trigger another issue: Can companies terminate their contractual obligations, because of EU sanctions imposed upon their counterparty? Pursuant to English case law (*Arash Shipping*

¹⁹ Cf. Article 2b and Annex II to Regulation (EU) No 692/2014, as amended.

²⁰ Cf. Article 2c of Regulation (EU) No 692/2014, as amended.

²¹ Cf. Articles 2a and 2d of Regulation (EU) No 692/2014, as amended.

²² The new measures adopted by the EU Council on 18 December 2014 include a further extension of the restrictions on investments, including acquisition of real estate, an expansion of the list of embargoed goods and technologies and the addition of restrictions on tourism in Crimea.

²³ Section 18(11) of the German Foreign Trade Act, available in English at http://www.gesetze-im-internet.de/englisch_awg/index.html.

²⁴ By way of an example, see Article 6 of Regulation (EU) No 208/2014.

Enterprises Co Ltd v Groupama Transport (2011))²⁵, a widely drafted force majeure clause may entitle an innocent party to cease performing its pre-existing contractual obligations due to the potential of breaching sanctions if the contract were to be performed. Under English law, no force majeure provision will be implied in the absence of specific contractual provisions. Thus, companies should ensure such clauses are expressly included in the contract and are carefully drafted to provide for the type of risks that could arise out of political instability, including the imposition of sanctions. The UK position contrasts with civil law jurisdictions, such as France or Germany, where parties may invoke force majeure even if the contract does not include an express provision to that effect.

Under English law, a company in contractual relations with a designated entity may also consider whether its contract has been frustrated, and is therefore capable of being terminated, because performance of contractual obligations has been rendered impossible due to supervening illegality. This doctrine, though, is not applied lightly. Recent English case law (*Melli Bank v Holbud Ltd* (2013))²⁶ indicates that the “*designation of [a person] did not render [the agreement at issue] incapable of performance where, as here, a licence could be sought and, on the evidence, could be expected to be forthcoming.*” Likewise, in *Islamic Republic of Iran Shipping Lines v Steamship Mutual Underwriting Association* (2010)²⁷, the English Court of Appeal held that a UK licence obtained from HM Treasury²⁸ did, in fact, permit the continuation of certain insurance services to the designated counterparty.

Companies should therefore be mindful that they may have to exhaust alternative options to secure contractual performance prior to seeking to rely on frustration as a basis to terminate a contract. In particular, companies may need to establish whether they could benefit from a derogation and obtain a licence from the relevant national competent authority.

Based on recent remarks by the European Parliament and Ms. Mogherini, the EU sanctions regime against Russia looks set to remain in place for the foreseeable future. European companies conducting business with Russian or Crimean counterparties will have to ensure that an adequate internal compliance infrastructure is in place, while continuing to monitor any future developments carefully. That said, this requirement may also present compliance teams with an opportunity to review internal procedures more broadly and emphasise the importance of this area internally.

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²⁵ [2011] EWCA Civ 260.

²⁶ [2013] EWHC 1506 (Comm).

²⁷ [2010] EWHC 2661 (Comm).

²⁸ Pursuant to the Financial Restrictions (Iran) Order 2009, available at http://www.legislation.gov.uk/ukxi/2009/2725/pdfs/ukxi_20092725_en.pdf, in conjunction with Para. 17, Schedule 7 of the UK Counter-Terrorism Act 2008, available at http://www.legislation.gov.uk/ukpga/2008/28/pdfs/ukpga_20080028_en.pdf.

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