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Be Proactive In Complying With Ukraine-Related Sanctions

Law360, New York (April 28, 2014, 12:32 PM ET) -- Trust, but verify. —Russian proverb.[1]

With U.S.-Russian relations rapidly icing over, anyone doing business in Eastern Europe should be aware of the trio of executive orders issued by President Obama in March 2014, blocking the transfer of property for certain individuals and companies connected to the Russia-Ukraine crisis. With the addition of a major Russian bank to the sanctioned parties list — and the potential for entire Russian industries to be targeted by additional sanctions under EO 13662 — U.S. businesses may not be prepared for the full reach of the Ukraine-related sanctions program. As recent events have shown, the Russian Federation still casts a long shadow over its predecessor's sphere of influence, as do its businesses and oligarchs.

Under the broad wording of the EOs, the sanctions program can extend far beyond the entities specifically named to include those who "materially assist," "sponsor" or "support" a sanctioned party. And, simply scanning the sanctions list every so often to see if any of your customers or business partners is named and then calling it a day is not a prudent policy. Like the proverb says, "trust, but verify." And, given the EO's expansive language and the possibility of still more expansive sanctions in the future, companies doing business in Eastern Europe should emphasize the "verify," rather than the "trust."

The Ukraine-related sanctions program is built on three EOs issued by President Obama in March of 2014: EOs 13660, 13661 and 13662. The EOs prohibit the transfer of any property held in the United States by sanctioned individuals/entities, and prohibits those individuals from entering the United States.[2] The sanctions are administered by the secretaries of the Treasury and State, who identify the individuals to be placed on the "specially designated nationals" list maintained by the Office of Foreign Assets Control of the U.S. Treasury.[3]

Violations of the EOs carry a civil penalty of up to $250,000 or twice the amount of any transaction that violates the order (whichever is greater), while a willful violation (including conspiracy, attempt, or

aiding and abetting a violation of the order) can result in criminal fines of up to a $1 million and a potential 20-year prison sentence.[4]

But what is likely the greatest concern to the business community is the expansive (and growing) reach of the Ukraine-related sanctions. While EO 13660 authorized sanctions against a relatively narrow category of parties including those that "undermine democratic processes" or "threaten the peace" in Ukraine,[5] the subsequent EOs have dramatically expanded the parties that may be sanctioned. EO 13661 authorized sanction of Russian "officials," any entity operating in the Russian "arms or related material" sector, or entities owned, controlled, or assisting a sanctioned party.[6] EO 13662 expanded the sanctions still further to include any party operating in any sector of the Russian economy, such as "financial services," "energy" or "defense," as designated by the secretaries of State and Treasury.[7]

The broad language of the EOs should be deeply worrisome to anyone with business ties to Eastern Europe. Among other things, the EOs makes it a violation "to have materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of" any sanctioned party or any entity "owned or controlled by, or to have acted or purported to act for or on behalf of" a sanctioned party.[8] Strictly read, this language could prohibit a vast range of seemingly-innocent transactions. Does a bank transferring payments for a sanctioned Russian official indirectly act "on behalf of" that official? Does a subcontractor providing screws to a Russian defense company provide goods and services "in support of" the sanctioned company?

Any observer can see that it is a violation to do business with parties expressly named in the OFAC SDN list. But how many of us are comfortable risking massive fines and potential criminal penalties on the question of whether a prospective business partner "materially assists" or "indirectly acts on behalf" of a sanctioned party"? And, for companies trying to do business in Eastern Europe, it may be impossible or impractical to impose such a multilevel quarantine around certain Russian businesses and institutions.

The addition of Bank Rossiya to the SDN list on March 20, 2014, is a good illustration of how these indirect relationships can be problematic. At a glance, Bank Rossiya would seem like a natural target for U.S. sanctions: The large, St. Petersburg-based lender has deep ties to both the former and current Russian governments and has long been considered a "personal bank" for President Putin and his inner circle.[9] Like any bank, Bank Rossiya sits at the center of a complex web of financial relationships, including large or controlling stakes in Russian television, newspaper, and mobile phone companies.[10]

These relationships make complying with U.S. sanctions a far more complicated prospect than simply avoiding Bank Rossiya itself and, in that sense, the black-and-white simplicity of the OFAC list can actually create a false sense of security. You may know that you (or your business partners) are not routing transactions through Bank Rossiya, but would you know that 50 percent of the mobile phone company, Tele2 Russia, is owned by Bank Rossiya,[11] making Tele2 an "owned or controlled" party per OFAC guidance and, thus, a prohibited party? Would you inquire as to whether the party you're doing business with is a major shareholder or a board member of Bank Rossiya (or any of its owned businesses), potentially bringing them within the ambit of "assisting" or "supporting" a sanctioned party? Does the IT company you're working with in Estonia or Lithuania, for example, provide computer

services that might amount to “technological support” for Bank Rossiya?

For all these reasons, complying with the Ukraine-related sanctions program is a potential minefield and, so far, very little of it has been mapped out. So, what can you do to navigate that minefield a little more safely?

Not surprisingly, the first thing any U.S. company with interests in the region should be doing is reviewing the OFAC SDN list regularly. With the situation in Ukraine still highly fluid, the SDN list can change quickly and a period of only a few days can see a dramatic expansion of the sanctioned parties (as was the case in the March 20, 2014, addition of Bank Rossiya and other individuals only three days after the last update to the Ukraine-related SDN list).

From a contract perspective, it also makes sense to put in place agreements with any foreign business partners (especially those in Eastern Europe) requiring them to review the SDN list regularly and inform you of any potential complications. While not an absolute safeguard by any measure, this at least demonstrates an effort to comply with the EOs and places the party most likely to know of any relationships with a prohibited party on the front line of your compliance effort. Additionally, it may be prudent to review or amend existing contract language to expressly address what happens if a party you’re already doing business with is added to the sanctions list midcontract.

These suggestions only scratch the surface of what could potentially become a major compliance headache for a wide range of U.S. businesses. In the end, the principle that best illustrates the danger, as well as the solution, is a Russian one: doveryai, no proveryai. It is a fine thing to trust your business partners and your understanding of their financial relationships. But with so much at stake in the Ukraine-related sanctions program, that trust should be backed by a healthy dose of verification.

—By Aidan Delgado and Ken Weckstein, Brown Rudnick LLP

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[1] Though popularized in the U.S. by President Ronald Reagan — to whom many mistakenly attribute the proverb — this Cold War-era catchphrase is actually a translation of the Russian saying “doveryai, no proveryai” [Доверяй, но проверяй].

[2] See Exec. Order No. 13,660, Blocking Property of Certain Persons Contributing to the Situation in Ukraine, 79 Fed. Reg. 13493 (Mar. 6, 2014) at §§ 1(a), 2.

[3] See id. at § 1(a).

[4] 50 U.S.C. §1705(b)-(c).

[5] See Exec. Order No. 13,660, supra n. 2, at § 1(a)(i)-(ii).

[6] Exec. Order No. 13,661, Blocking Property of Additional Persons Contributing to the Situation in Ukraine, 79 Fed. Reg. 15,535 (Mar. 16, 2014), at § 1(a)(ii)(A)-(D).

[7] Exec. Order No. 13,662, Blocking Property of Additional Persons Contributing to the Situation in Ukraine, 79 Fed. Reg. 16,169 (Mar. 20, 2014), at § 1(a)(i)-(iii).
[8] See Exec. Order No. 13,661, supra n. 6, at § 1(a)(ii)(C)-(D).

[9] See, e.g., Catrina Stewart, Bank Rossiya Emerges From Shadows, The Moscow Times (Jul. 10, 2008), available at: ≪http://www.themoscowtimes.com/business/article/bank-rossiya-emerges-from-shadows/368844.html≫ (last visited April 21, 2014); Irina Reznik, et al., Putin Bank Trail Runs from Communist Cash to Billionaires, Bloomberg Business Week (Apr. 16, 2014), available at: ≪http://www.bloomberg.com/news/2014-04-16/putin-bank-trail-runs-from-communist-cash-to-billionaires.html≫ (last visited April 21, 2014).

[10] See Reznik, et al., supra n. 9; Ekaterina Shatalova, Bank Rossiya Seeks to Buy 50% Stake of Tele2 Russia From VTB, Bloomberg Business Week (Oct. 4, 2013), available at: ≪http://www.businessweek.com/news/2013-10-04/bank-rossiya-seeks-to-buy-50-percent-stake-of-tele2-russia-from-vtb≫ (last visited April 21, 2014).

[11] Shatalova, supra n. 10.
