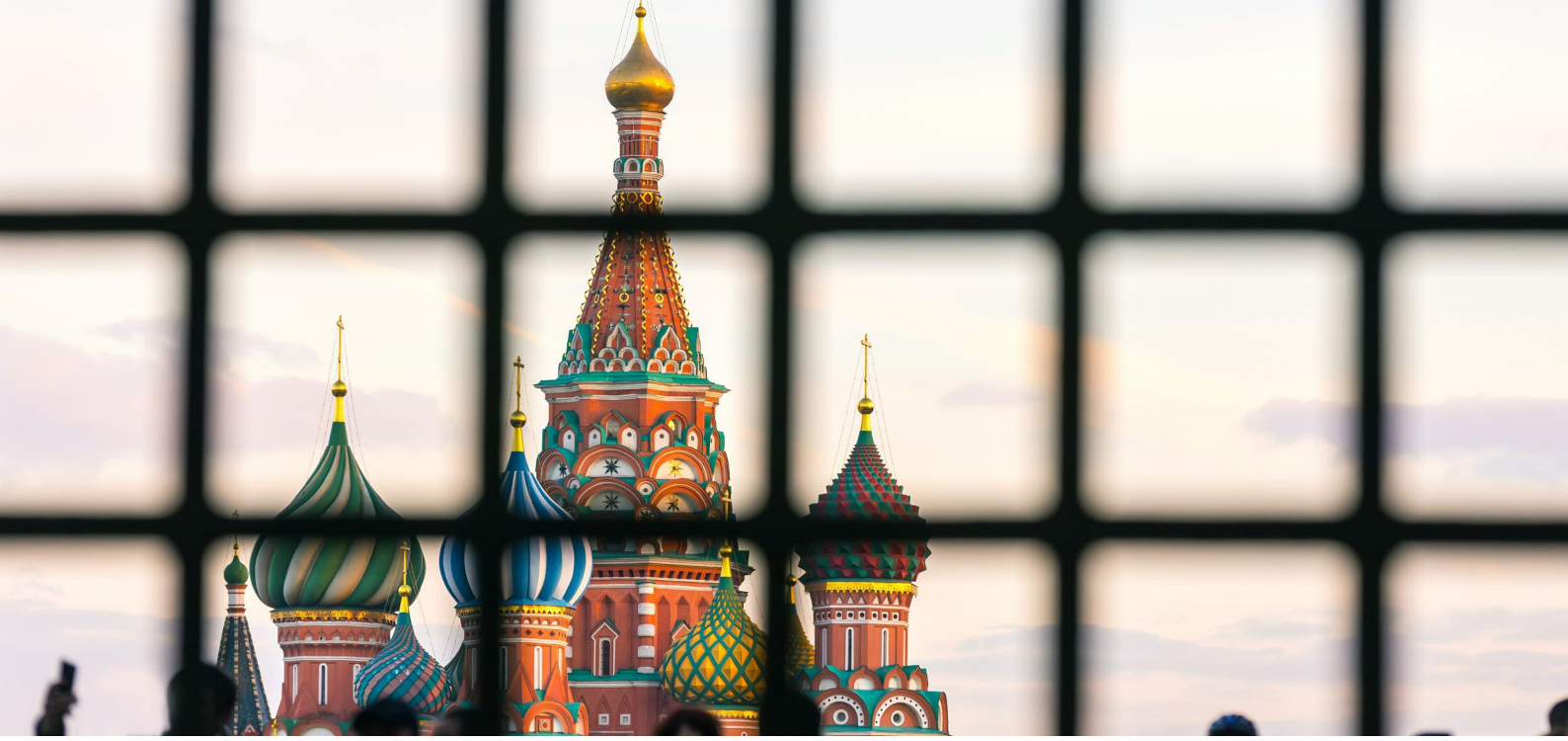

Putin's war: key steps for complying with rapidly escalating sanctions

Companies worldwide have been forced – or have chosen – to bring business with a nexus to Russia to a lurching halt, after the United States and its allies threw a wall of new and expanded sanctions around Moscow in their response to the invasion of Ukraine. The tough sanctions from the United States, EU, United Kingdom, and allies from further afield are unprecedented in their scope and scale. Among other things, they intend to economically shackle Russia's finance, energy, tech and military-industrial sectors as well as hundreds of powerful individuals, including President Putin himself.

Unprecedented activity

The US response has included a dramatic expansion in export controls on technology, including license requirements for items in Commerce Control List ("CCL") Categories 3-9. In some cases, the new controls apply to EAR99 items subject to the Export Administration Regulations ("EAR"), with goods such as Microsoft Office products, software apps, laptops and spare parts for commercial aircraft all affected. Likewise, controls on the export of non-US goods produced using US technology or software have been ramped up.

The UK, EU and other allies have mirrored the US, putting in place similar restrictions aimed at choking off Russian access to technology that could be used militarily, including spare parts for aircraft and semiconductor chips. Taiwan, the largest supplier of semiconductor chips worldwide, and on which Moscow has traditionally depended for chips for everything from laptops, smartphones and its military and security services, has halted shipments to Russia.

> Multilateral restrictions across jurisdictions requires a diligence process that considers more than just one set of laws and regulations.

The new multilateral injunctions include global designations of hundreds of powerful Russians and oligarchs, making business through the opaque web of companies that many of them own around the world, very risky and dangerous in the absence of stellar due diligence.

"Most of our clients who are selling to Russia, particularly in the tech sector, have essentially frozen those sales and are evaluating whether or not they can continue, in some instances where the licensing exceptions remain," says Ryan Fayhee, Partner at the law firm of Hughes Hubbard & Reed in Washington, DC.

Supply chain diligence gets even more challenging

Hours after the first Russian troops and tanks rolled into Ukraine on 24 February and global sanctions against Moscow were declared, trade lawyers reported a flood of calls and emails from clients worried about the impact on their businesses. At the time, Giovanna Cinelli, leader of the international trade and national security practice at Morgan Lewis in DC, told participants of the *WorldECR* Virtual Forum that clients were concerned "primarily about what can be done and under what circumstances.

"We are seeing a sliding scale of reactions from complete paralysis, unable to make a decision on what to do, to deciding to do nothing until there is something more definitive," she said. "We're also seeing an enormous amount of angst about how do we move money and how do we protect assets that we have in the various jurisdictions."

Even with general licenses and wind-down provisions from the US side that allow some humanitarian and telecommunications work to continue, there is "quite a bit of consternation on exactly what can and can't be done."

In comments to *ECM* two weeks later, Cinelli stressed that multilateral restrictions across jurisdictions requires a diligence process that considers more than just one set of laws and regulations.

"Must-reads" at www.exportcompliancemanager.com

- "Navigating US Russian sanctions: what to consider", KPMG, issue 20
  https://exportcompliancemanager.com/articles/navigating-us-russian-sanctions-what-to-consider/
- "Cryptocurrency transactions and sanctions compliance", Deloitte, issue 19
  https://exportcompliancemanager.com/articles/cryptocurrency-transactions-and-sanctions-compliance/
- "Global sanctions compliance programs: when and how to use a common baseline", Melissa Duffy, issue 9
  https://exportcompliancemanager.com/articles/global-sanctions-compliance-programs-when-and-how-to-use-a-common-baseline/
- "The OFAC 50% rule: three steps to enhance the control framework", Kharon, issue 5
  https://www.exportcompliancemanager.com/articles/the-ofac-50-rule-three-steps-to-enhance-the-control-framework/#nogo
- "Sanctions: step quickly, carefully", Nathan Eilers, issue 5
  https://exportcompliancemanager.com/articles/sanctions-step-quickly-carefully/

This "results in supply chain diligence taking on a more multilateral framework," Cinelli says. "Current supply chain diligence has become more complicated."

Consequently, a real challenge for businesses now is how to identify and guard against every prohibited touchpoint to Russia.

"Unfortunately, there are no shortcuts," says Tahlia Townsend, a Partner at Wiggin and Dana in DC. "Companies have to identify all customers, suppliers, and banks with which they transact in Russia, Belarus, and Ukraine, check those parties against sanctions lists and, unless they are using a screening tool that includes beneficial ownership and related business intelligence information, manually determine ownership and perform additional screening to rule out 50% Rule problems."

Townsend told *ECM* that companies are having to grapple with OFAC's 50% Rule – where an entity that is not on a sanctions list is subject to sanctions based on ownership by one or more sanctioned parties – "in a way many had never done before. As a result of the 50 Percent Rule, there could also be suppliers, customers, and banks outside Russia and Belarus that are subject to sanctions but, as a matter of triage, it makes sense to focus on Russia and Belarus first."

She notes that screening parties to satisfy the rule is tremendously time-consuming, requiring research in Cyrillic and creating a huge recordkeeping burden. Companies that have the resources should invest in specialized screening software, says Townsend, while warning that "this isn't always perfect."

Cinelli, meanwhile, observes that "the lack of transparency embedded in the 50% Rule creates foundational compliance challenges." She says, "Since OFAC does not designate, as specially designated nationals (SDNs), those parties that are owned 50% or more by an SDN, companies are left to identify resources that can provide that data."

Sebastiaan Bennink is a Partner at the law firm of BenninkAmar in Amsterdam, the Netherlands. He says that companies would be well advised to include sanction clauses, including termination options and pre-payment clauses, in existing or new contractual arrangements to guarantee payment in case of new sanctions or restrictions.

"Furthermore, companies should ensure that Russian law does not apply to any contractual agreement that is being arranged, since Russian law does not recognise the application of foreign sanctions," he stresses.

Solid screening essential

At a time like this, robust screening is a must-have. According to Fayhee, companies and banks would do well to heighten vigilance over incoming international payments. "Whenever there's law enforcement attention, whenever there's new restrictions, entity listings and the like, you see new creative ways to be paid as a means to work around those restrictions," he explains.

Among other things, companies should watch out for practices like suppliers or customers looking to introduce alternative payment mechanisms, such as a customer ordering a product and then introducing a third party to accept payment or to make payment on their behalf. Fayhee notes that many companies will already restrict this so as to protect against sanctions evasion or money laundering.

> "The current crisis is teaching many a hard lesson about termination clause hygiene."

"Companies should invest in training up their frontline business or salespeople or procurement arm to be on the lookout for red flags such as these," he says.

Get me out of here!

For companies looking to pull out of business over sanctions worry, this is the time to review contracts for clauses like *force majeure*.

"For purposes of the current hostilities, the approach taken not only by the United States but also by the EU and other countries worldwide to punish Russia for its actions has been expansive in a unique way," notes Jeremy Page, Partner at international trade law firm Page Fura in Chicago. "It would behove companies operating in the global theatre to consider expanding their *force majeure* provision to incorporate those tools. Beyond that consideration, classic contract remedies such as impossibility, frustration of purpose or impracticability might apply but these are all dependent upon the law chosen to govern the underlying agreement.'

Townsend observes that, because *force majeure* rules vary from jurisdiction to jurisdiction and it isn't always possible to rely on such a clause in the case of a sanctions or export control problem, "It is much safer to have a clause that explicitly identifies sanctions and export controls as a grounds for termination. The current crisis is teaching many a hard lesson about termination clause hygiene."

In the EU, Bennink explains, terminating contracts can actually result in a violation of sanctions from an EU law perspective. Under the asset freeze, financial institutions must, for example, immediately freeze the financial assets of sanctioned parties and prevent financial assets and economic resources from being made available. But according to the Dutch central bank, financial institutions are not allowed to terminate the relationship with existing customers, as terminating agreements goes beyond freezing funds and economic resources.

"Therefore, when dealing with the implications of an asset freeze, we would advise financial institutions to freeze all assets and transactions in case a Russian business relation is sanctioned, before assessing whether it is legally permitted to terminate a contract with a sanctioned person or entity," says Bennink.

So, remember, don't rush to terminate a contract. Cinelli advises that, terminating contracts should be done with care, warning that, while options exist for deciding when and how to suspend or terminate contract performance, "an incomplete analysis of the potential consequences can result in litigation and other regulatory impacts." ■