

E-ALERT | International Trade Controls

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EUROPEAN UNION ISSUES NEW SECTORAL SANCTIONS AGAINST RUSSIA

As previewed in our [client alert](#) dated July 30, 2014, on the evening of July 31, 2014, the European Council issued [Council Regulation No. 833/2014](#) (“Regulation”), introducing a range of new export controls and financing restrictions against Russia. The new Regulation, together with Council Regulation 825/2014 (summarized in our prior alert), represents a major step-change in the European Union’s approach to the Russia-Ukraine conflict. It reflects an emerging consensus among the EU Member States – including some Member States that had previously exhibited reluctance to support major sanctions against Russia – that European sanctions could represent an important tool in persuading Russia’s political leadership to play a constructive role in resolving the conflict. The new measures are also undoubtedly motivated, in part, by the dramatic events surrounding the downing of Malaysian Airlines Flight MH17.

Perhaps reflecting the compromises that led to the Regulation’s passage, the document is not a model of clarity, and the EU Member State implementing authorities will likely be asked in the coming days and weeks to provide guidance concerning its key provisions. The following summarizes the new prohibitions and restrictions that the Regulation introduces, together with our perspective as to certain areas where the Regulation leaves open questions.

MILITARY TRADE CONTROLS

Article 2 of the Regulation prohibits the sale, supply, transfer or export, directly or indirectly, of dual-use goods and technology, whether or not originating in the EU, to any natural or legal person, entity or body in Russia or “for use in Russia,” if those items may be intended, in their entirety or in part, for “military use” or for a “military end-user.” The Regulation provides that where the end-user is the Russian military, any dual-use goods and technology procured by it shall be “deemed” to be for military use.

The Regulation does not define the term “military end-user,” and hence it is unclear whether, or in what circumstances, the Regulation would restrict the export of dual-use items to a Russian party that has both military and non-military components to its business. However, the Regulation provides that Member States’ authorities should decline license requests for dual-use exports to Russia where there are “reasonable grounds to believe” that the end-user might be a “military end-user.” Hence, it would appear plausible that the EU Member States should be permitted to license dual-use exports to Russian companies who are engaged in both the defence and civilian sectors, if the exported items are intended to be used strictly in connection with the end-user’s civilian operations.

Article 4(1) of the Regulation separately restricts the provision to any person/entity in Russia, or “for use in Russia,” of technical or financial assistance relating to the items on the Common Military List, or dual-use items intended for a military end use or end-user. The Regulation likewise restricts brokering services associated with dual-use items intended for any Russian party or “for use in” Russia.

Exports of military items to Russia are not covered under the Regulation, as the implementation of military export controls is, as a general matter under EU law, left to the cognizance of the individual Member States. (For that reason, arms embargoes are adopted via Council decisions, which are then implemented in Member States' national laws, rather than via Council Regulations, which are directly applicable to private parties.) Accordingly, a separate Council Decision was issued yesterday, [Council Decision 2014/512/CFSP](#), requiring the EU Member States to implement measures to prohibit the supply of arms and related military items to Russia, as well as related technical, financial/insurance, and brokering services. The Council Decision also requires Member States to prohibit transactions relating to the import, transport, or purchase of military items from Russia.

Notably, the foregoing prohibitions in the Regulation and related Council Decision are subject to a number of important exemptions. The trade controls in Article 2 of the Regulation are subject to a licensing provision that would allow Member States to issue licenses to permit the sale, supply, transfer or export of restricted items in respect of contractual obligations that arose before 1 August 2014. The military-related restrictions in Article 4(1) are subject to a broader grandparenting provision that would allow transactions covered by the Article 4(1) restrictions to continue *unlicensed* if they arose from a contract or agreement concluded before August 1, 2014. The Regulation sets forth a further grandparenting exemption – not limited to obligations pre-dating August 2014 – for activities restricted under Article 4(1) that involve the “provision of assistance necessary to the maintenance and safety of existing capabilities within the EU.”

The EU Member States are permitted to implement similar exemptions in connection with the arms trade prohibitions set forth in the Council Decision.

OIL AND GAS “TECHNOLOGY” CONTROLS

Article 3 of the Regulation imposes new restrictions on the sale, supply, transfer, or export, directly or indirectly, of “technologies” listed in Annex II to the Regulation, to any party in Russia or to any third country “for use in Russia.” The items in Annex II contain a broad range of pipes, casings, tubings, and other tools and equipment used in oil and gas exploration and production activities.

The Council’s use of the term “technologies” has created a degree of confusion concerning the scope of the Article 3 restrictions. Drafts of Article 3, which were leaked to the press last week, suggested that Article 3 would restrict “equipment and technology.” Moreover, similar oil and gas trade controls implemented in other sanctions regulations – such as the EU sanctions against Iran and Syria, and the trade controls restrictions implemented earlier this week in relation to Crimea¹ – explicitly restrict transactions related to both “equipment” and “technology.” It is unclear why the Council chose to depart from its typical approach and rely on the term “technologies” in Article 3, and whether that drafting decision is intended to signal that Article 3 is meant to focus on technology rather than hardware exports. Compounding that ambiguity, the term “technologies” is not defined in the Regulation, and whereas Annex II is described as a list of “technologies,” it in fact describes a series of hardware products.²

It is anticipated that EU Member State authorities will issue clarifying guidance that will allow for a more definitive resolution of this question. In the meantime, it would be prudent for companies subject to the jurisdiction of the Regulation to assess whether they have any impending exports of Annex II hardware or technology to Russia or to third countries with the intent that they will be used

¹ See European Council Regulations 36/2012, at Article 8 (Syria); 267/2012, at Article 8 (Iran), and 825/2014, at Article 2c (Crimea).

² Moreover, we note that Article 3(1) states that restrictions would apply if Annex II “equipment or technology” is for use in Russia.

in Russia. As Annex II lists a range of items that are not caught under the EU Common Military List or Dual Use List, those products are unlikely to be classified as export-controlled items under most companies' existing EU export controls compliance systems.

Article 3 contains a licensing provision that allows Member States to issue licenses for the export of Annex II items to or for use in Russia. License requests will be denied, however, for exports relating to projects pertaining to deep water oil exploration and production, unless those exports are required under a contractual obligation that was concluded prior to August 1, 2014.

In addition to the restrictions set forth in Article 3, and similar to the military restrictions in Article 2, Article 4(3) of the EU Regulation requires licenses for the provision of "technical assistance" or brokering relating to the technologies and hardware items listed in Annex II, and to the provision, manufacture, maintenance and use of those items, directly or indirectly to any natural or legal person, entity or body in Russia or for use in Russia. A license will also be required for financing or financial assistance related to technologies referred to in Annex II.

NEW FINANCIAL SECTOR RESTRICTIONS

Article 5 of the Regulation restricts access to capital markets for certain Russian financial institutions, designated in Annex III to the Regulation. Those entities currently include the following Russian banks: Sberbank, VTB Bank, Gazprombank, Vnesheconombank (VEB), and Rosselkhozbank.

Article 5 prohibits directly or indirectly purchasing, selling, providing brokering or assisting in the issuance of, or otherwise dealing with transferable securities and money-market instruments with a maturity exceeding 90 days, issued after August 1, 2014 by:

- entities designated in Annex III;
- any entity *established outside of the EU* that is not designated in Annex III but whose proprietary rights are more than 50% owned by any entity designated in Annex III;
- any entity "acting on behalf or at the direction of" any entity referred to above.

Those measures thus contain an important carve-out, as they do not apply to affiliates of the listed financial institutions that are *established* within the EU. The Regulation does not make clear, however, how or whether the Article 5 restrictions may extend to *branches* of Annex III banks that are established in Russia but based within the EU.

The terms "money-market instruments" and "transferable securities" are defined in the Regulation, using definitions borrowed from the EU Markets in Financial Instruments Directive (Directive 2004/39/EC) (MiFID) to cover "those classes of securities which are normally dealt in on the money market," and "those classes of securities which are negotiable on the capital market," with several examples of such instruments given (e.g. shares in companies, securities equivalent to shares, bonds or other forms of securitized debt, treasury bills, and certificates of deposit). The definitional sections of the MiFID, related legislation (including EU Member States' implementations of the MiFID), and other related guidance surrounding the MiFID will serve as reference points in evaluating the specific types of instruments that fall within the Regulation's Article 5 restrictions.

The Article 5 measures bear some similarities to the new equity and debt restrictions imposed by the United States in July (as described in our July 30, 2014 alert), although different Russian entities are covered by the US and EU measures and there are certain important differences in the scope of the substantive restrictions between the two regimes. For example, whereas the U.S. measures

potentially cover a broad range of debt and equity instruments, the EU restrictions applicable to “transferable securities” and “money-market instruments” do not appear to be intended to cover certain types of loans, and it is unclear whether (or in what circumstances) they may cover other instruments that fall into the U.S. sanctions’ definitions of “debt” and “equity.”

It is important to bear in mind that the Article 5 sanctions are not asset blocking measures—apart from the specific categories of transactions set forth in Article 5, EU parties are not more broadly prohibited from conducting business with Annex III parties or their affiliates. Companies affected by the Regulation should, however, ensure that they have conducted screening measures sufficient to assess potential connections with the Annex III banks or their majority-owned non-EU affiliates, in addition to more broadly screening the consolidated EU financial sanctions list.

JURISDICTIONAL REACH OF THE REGULATION

Consistent with other EU sanctions regulations, the Regulation applies (1) to conduct by EU-incorporated entities and EU nationals anywhere in the world; (2) to conduct by any party, irrespective of nationality, in connection with activities occurring in the territory of the EU or (with regard to legal persons) in respect of business “done in whole or in part within the Union”; or (3) conduct on board any aircraft or vessel under the jurisdiction of a Member State.

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The Regulation represents the latest, although perhaps not the last, EU sanctions regulation relating to the Russia/Ukraine crisis. The EU has signalled that it will closely monitor the implementation of the Regulation and its impact, and it will consider supplemental measures if circumstances in Eastern Ukraine warrant and consensus among the 28 Member States can be reached. We understand that the EU has already developed drafts of additional “sectoral” sanctions, as well as a short-list of additional targets for potential asset freezing measures, that may be considered.

We are continuing to closely monitor developments concerning the EU and US sanctions against Russia and Crimea, and we will publish further alerts as material developments arise. In the meantime, if you have any questions please feel free to contact any of the lawyers identified below.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our international trade controls practice group:

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