E-ALERT | International Trade Controls

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U.S. COMMERCE DEPARTMENT RESTRICTS ENERGY-RELATED EXPORTS AND REEXPORTS TO RUSSIA

On August 6, 2014, in response to Russia's continuing policy of destabilization in Ukraine and continuing occupation of Crimea and Sevastopol, the U.S. Department of Commerce's Bureau of Industry and Security ("BIS") published a final rule (79 Fed. Reg. 45675, the "BIS Final Rule") that imposes stringent new export control restrictions on certain items for use in Russia's energy sector. The new rule, which was previewed in our e-alert dated July 30, 2014, also amended the Export Administration Regulations ("EAR") to strip Russia of its favorable license review status for items subject to national security controls under the EAR, and added a Russian state-owned defense and shipbuilding company, United Shipbuilding Corporation, to BIS's Entity List, restricting trade in EAR-controlled items with the company.

BIS's new rule roughly parallels the European Council's new export controls targeting Russia's energy sector, which we described in our e-alert dated August 4, 2014. There are, however, several key differences in their respective scopes.

I. U.S. RESTRICTIONS ON ENERGY-RELATED EXPORTS AND REEXPORTS

Russian Industry Sector Sanctions

The BIS Final Rule adds new "Russian Industry Sector Sanctions" to the EAR (in § 746.5). The new provisions require a license for any persons, including non-U.S. persons, to export or reexport, or transfer to a third party outside the United States, certain items subject to the EAR if the person making the export, reexport, or transfer knows or is informed (or is unable to determine whether) the item will be used directly or indirectly in Russia's energy sector for exploration or production from deepwater or Arctic offshore locations, or in shale formations in Russia that have the potential to produce oil or gas. "Deepwater" is defined as being deeper than 500 feet; "Arctic" is not defined.

The items subject to the new Russian Industry Sector Sanctions are those:

- Listed in a new Supplement No. 2 to EAR Part 746, which includes a wide range of pipe, well tubings and casings, drill bits and tools, oilfield pumps, gas separation equipment, oil drilling and production platforms and machinery, wire line and downhole equipment, drilling derricks, and the like. The items are listed by their Census Bureau Schedule B number.
- Classified under any of six existing Export Control Classification Numbers ("ECCNs") to which a new Russia Industry Sector Sanctions reason for control has been added. These are 1C992 (commercial charges and devices), 3A229 (firing sets and equivalent high-current pulse generators), 3A231 (neutron generator systems), 3A232 (detonators and multipoint initiation

systems), 6A991 (marine or terrestrial acoustic equipment), and 8A992 (vessels, marine systems, or equipment and various parts, components, and related items).[1]

- Classified under either of two new ECCNs, 8D999 and 0A998. ECCN 8D999 controls software specially designed for the operation of unmanned vessels used in the oil and gas industry of Russia. ECCN 0A998 controls oil and gas exploration data, including seismic analysis data, hydraulic fracturing design and analysis software and data, and hydraulic fracturing materials as identified in the entry. The oil and gas data controlled under this new ECCN does not meet the definition of "technology" under the EAR, which is defined as specific information necessary for the development, production, or use of items on the EAR's Commerce Control List.[2] BIS has stated that the data controlled under this ECCN includes analyses of raw seismic or other types of data, but has not clarified whether the ECCN broadly includes any data—whether raw or processed—related to oil and gas exploration, nor has it defined the term "data."

Importantly, these restrictions apply to any covered item that is being exported, reexported or transferred by *any* person, including a non-U.S. person, if the item is "subject to the EAR." Items "subject to the EAR" include items that are (i) being exported from the United States, regardless of their origin; (ii) U.S.-origin items, regardless where they are currently located (even if they are already located outside of the United States); and (iii) non-U.S. origin but contain more than 25% controlled U.S.-origin content (by value). Note that "controlled" U.S. content for these purposes does not mean all U.S. content, but rather only U.S. content that would require licensing for export to Russia.

The above new restrictions are in addition to license requirements for Russia as set out in the EAR's Commerce Country Chart. We understand that BIS is likely to issue responses to "frequently asked questions" in the next several weeks to provide further interpretive detail regarding these new provisions.

Items subject to this new licensing requirement are not eligible for any of the EAR's license exceptions except the "GOV" exception, which authorizes certain exports, reexports, and in-country transfers to the U.S. Government and cooperating governments.

The new Russian Industry Sector Sanctions further provide that applications for the export, reexport, or transfer of any item that requires a license for Russia will be reviewed with a presumption of denial when there is potential for use directly or indirectly for exploration or production from deepwater, Arctic offshore, or shale projects in Russia that have the potential to produce oil. (The fact that this licensing policy statement does not also mention the production of gas is intentional, in order to conform with the new EU measures.) We understand that BIS is encouraging exporters to contact BIS in situations where the exporter/reexporter has information that an EU-based company will be able to supply a competing product under the new EU measures, so that BIS can engage with the relevant European government as appropriate.

Finally, EAR § 746.5 notes that BIS also may inform persons, either individually by specific notice or through amendment to the EAR, that a license is required for a specific export, reexport, or transfer, or the export, reexport, or transfer of specified items to a certain end-user, because there is an unacceptable risk that the item at issue will be used in or diverted for use in the above-described Russian oil or gas exploration or production activities that are the target of the new sanctions.

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[1] We note that in its summary of the Final Rule, BIS describes the covered items as including various products, such as "compressors," "expanders" and "valves." It is not clear at this point where those listed items are covered in the Schedule B numbers and ECCNs that BIS has identified.
[2] As a result, there is a lack of clarity regarding the potential application to such "data" of various BIS controls tied to "technology," *e.g.* the deemed exports controls contained in EAR § 734.2(b).

No Grandfather Provision

The BIS Final Rule does not contain a grandfather provision exempting from its reach exports, reexports, or in-country transfers in furtherance of contracts entered into prior to August 6, 2014. In fact, BIS emphasizes in the Final Rule's preamble that this means even shipments aboard a carrier en route to a port of export or reexport as of August 6 may not proceed to Russia if, as a result of the Final Rule, they are no longer eligible for export or reexport to Russia without a license or under a license exception.

On the other hand, we understand that the Final Rule does not require items exported or reexported to Russia prior to August 6, 2014 to be withdrawn from Russia, though a covered item already in Russia will require a license to be transferred to another entity if a license would be required for the export of the item to Russia. Further, the rule does not restrict exports, reexports, or in-country transfers pursuant to a license granted by BIS prior to August 6, 2014.

II. OTHER EXPORT RESTRICTIONS

In addition to the above-described restrictions it imposes on certain energy-related exports, the BIS Final Rule also amends the EAR to remove Russia's favorable license review status for items subject to the EAR's national security controls. This means that BIS now will only approve license applications to export or reexport such items to Russia (to the extent they are not subject to the new presumption of denial) upon an individualized determination that the items are for civilian use or would otherwise not make a significant contribution to the military potential of Russia that would prove detrimental to U.S. national security.

The BIS Final Rule also added the Russian state-owned defense and shipbuilding company, United Shipbuilding Corporation, to BIS's Entity List. As a result, a license from BIS is now required for any person, including a non-U.S. person, to export, reexport, or transfer abroad any item subject to the EAR to United Shipbuilding, and applications for such licenses are subject to a presumption of denial. The U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") also recently added United Shipbuilding to its List of Specially Designated Nationals and Blocked Persons ("SDN List"), subjecting United Shipbuilding (and entities in which it owns a 50% or greater interest) to asset-blocking measures in addition to the export restrictions imposed by BIS.

III. COMPARISON OF NEW U.S. RUSSIA RESTRICTIONS TO NEW EU CONTROLS

As noted above, the Russian Industry Sector Sanctions are similar to new EU export controls, codified in European Council Regulation No. 833/2014 of July 31, 2014 ("EU Regulation"), restricting the sale, supply, transfer, or export, directly or indirectly, of "technologies"— which we understand to include both equipment and technology — for oil and gas exploration or production in Russia. There are, however, several differences between the two regimes that companies subject to both will need to account for in their compliance efforts. The following are three of the most significant differences:

- The BIS Final Rule only imposes a licensing requirement as to certain items intended for energy exploration or production from deepwater, Arctic offshore, or shale projects in or offshore Russia. By contrast, the EU Regulation imposes a licensing requirement for all exports of items listed in Annex II to the Regulation to or for use in Russia, regardless of end use. Annex II contains a broad range of pipes, casings, tubings, and other tools and equipment used in oil and gas exploration and production activities. The items listed in Annex II substantially overlap with the items controlled under the new BIS Final Rule, but there are some differences between the items controlled under the two regimes.

- In addition, while the new BIS Final Rule requires that applications to export, reexport, or transfer (in-country) items destined for deepwater, Arctic offshore, or shale projects in or offshore Russia are subject to a "presumption of denial," the EU Regulation flatly prohibits EU Member States from licensing such activities unless they relate to the execution of an obligation arising from a contract or an agreement concluded before August 1, 2014. However, as noted the EU Regulation thereby does contain a "grandfathering" approach which is not included in the BIS Final Rule.
- Another key difference is that the EU Regulation, unlike the new BIS Final Rule, imposes a licensing requirement for the provision of "technical assistance" or brokering related to the technologies and hardware items listed in its Annex II.

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We are continuing to closely monitor developments concerning the U.S. and EU sanctions and export control restrictions related to the Ukraine crisis, and we will publish further alerts as material developments arise. We are well-positioned to advise companies and individuals regarding the impact the BIS Final Rule will have on their operations, as well as on compliance with other U.S. and EU sanctions and export control restrictions related to the Ukraine crisis.

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:

Peter Flanagan	+1.202.662.5163	pflanagan@cov.com
Corinne Goldstein	+1.202.662.5534	cgoldstein@cov.com
Peter Lichtenbaum	+1.202.662.5557	plichtenbaum@cov.com
David Lorello	+44.(0)20.7067.2012	dlorello@cov.com
Lisa Peets	+44.(0)20.7067.2031	lpeets@cov.com
Kim Strosnider	+1.202.662.5816	kstrosnider@cov.com
David Addis	+1.202.662.5182	daddis@cov.com
Stephen Bartenstein	+1.202.662.5471	sbartenstein@cov.com