

# Sectoral Sanctions Add New Layer of Complexity to OFAC Sanctions

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In response to the protracted crisis in Ukraine, the Obama administration authorized traditional and innovative economic sanctions against Russian and Ukrainian persons through Executive Orders 13660, 13661, 13662 and 13685. In keeping with other traditional sanctions programs, the U.S. government has added dozens of Russian and Ukrainian entities and individuals to the Specially Designated Nationals and Blocked Persons List (SDN List) since March 2014. The SDN List details the specific targets of U.S. sanctions, and these traditional U.S. sanctions prohibit any transactions involving designated persons and U.S. persons or the territory of the United States. In December 2014, the president also prohibited U.S. investment in or trade with the Crimean region. The recent sanctions against Crimea are comparable to other comprehensive sanctions programs the U.S. maintains against Sudan, Iran, Syria and Cuba. In July 2014, however, the U.S. government created an entirely new type of sanctions regime, the "sectoral sanctions," that aims to limit certain sectors of the Russian economy from gaining access to U.S. capital and debt markets, as well as U.S. technology and expertise in the energy sector.

For various reasons, the Ukraine-related sanctions have posed significant compliance challenges. Unlike the targets of other U.S. sanctions programs, many targets of the Ukraine-related sanctions are highly integrated into the global economy due to their participation in international trade and their vast global holdings. Businesses must ensure that they are not engaging in prohibited transactions with this large and active network of companies. Additionally, companies operating in multiple jurisdictions often must comply with sanctions imposed by several governments: The United States, G-7 and EU countries have imposed overlapping, and sometimes differing, sanctions. Additionally, an active U.S. Congress may encourage even more aggressive and unilateral sanctions on the part of the United States. All of these factors — against the backdrop of a strict-liability regime — complicate compliance with U.S. sanctions, particularly for companies engaging in highly complex transactions, managing business matters across multiple jurisdictions or operating in the sectors targeted by these sanctions.

**The Novelty of Sectoral Sanctions.** Sectoral sanctions are an entirely new breed of sanctions for which the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) has issued several directives. To date, however, OFAC has provided limited guidance or interpretation on its directives, and it remains unclear how OFAC will enforce them. On July 16, 2014, OFAC created a new Sectoral Sanctions Identifications (SSI) List pursuant to Executive Order 13662, which had authorized sanctions against certain sectors of the Russian economy, including the financial services, energy, mining, and defense and related materiel sectors. Pursuant to OFAC's first three SSI directives, transactions involving U.S. persons or the United States are prohibited to the extent that the transactions involve the issuance by SSI entities of new debt (and in some cases new equity) that exceeds 30 or 90 days' maturity. The concepts of debt and equity can appear relatively simple in the abstract, but their application to highly complex international financial transactions is more difficult. Businesses have been struggling to determine whether certain agreements, financial instruments or components of complex transactions would fall under OFAC's simplified definition of debt and equity.

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Businesses may wish to consider all aspects of a transaction that could give rise to an SSI List entity owing an obligation that exceeds 30 or 90 days' maturity and that involves a U.S. nexus.

**Due Diligence of the Ownership Structure of Targeted Entities.** As with all U.S. sanctions, the Ukraine-related sanctions apply to any entity owned 50 percent or more by a sanctioned person. Based on recent guidance from OFAC, this rule now applies to aggregate ownership by sanctioned persons. The individuals and companies designated under the Ukraine-related sanctions often have vast and sometimes nontransparent holdings throughout the world, meaning that businesses cannot simply screen counterparties' names against the OFAC lists. They also must determine whether sanctioned persons directly or indirectly own — in the aggregate — 50 percent or more of their counterparties. As a result, due diligence of counterparties should go beyond only screening counterparty names against watchlists to include analyzing ownership structures.

**SDN Involvement in Management and Board Representation of Nonsanctioned Entities.** Several of the individuals that have been designated as SDNs hold leadership positions in large enterprises throughout Russia. In many cases, the companies for which they are directors or officers are not sanctioned. OFAC has explained that when a blocked person controls, but does not own, 50 percent or more of an entity, the entity is not automatically blocked. OFAC, however, has advised U.S. persons to act with caution when transacting business with an SDN in his or her capacity as an official representative of a nonsanctioned entity. OFAC indicated that in certain circumstances, U.S. persons may not execute a contract with a nonsanctioned entity when the contract is countersigned by an SDN, even when the SDN does not own 50 percent or more of the counterparty. The positions advanced by OFAC are novel, and the enforcement landscape is evolving.


**Different Sanctions Across Jurisdictions.** The U.S. has imposed sanctions against Russian persons in conjunction with the European Union, Canada, Australia and other jurisdictions. However, the lists of sanctioned parties are not identical, and the scope of the sanctions varies. Moreover, businesses have had to navigate Russian countermeasures imposed in response to Western sanctions. To date, the Russian countermeasures are limited to an import ban on certain food products originating from the United States, EU and other states and an import ban on certain consumer goods, if the goods will be used by the Russian state. As a result, companies operating in multiple jurisdictions not only must understand and comply with the U.S. sanctions but should heed the sanctions in these other jurisdictions as well.

**U.S. Legislative Outlook for 2015.** From the onset of the crisis, the Obama administration has opted to coordinate with the G-7 and European Union on each of its sanctions announcements pertaining to events in Ukraine. On December 18, President Obama signed legislation authorizing new sanctions on the Russian energy and defense sectors. His action was based on the “flexibility” provided in the legislation, including waiver authority. The new Congress that convened this month, led by Republican majorities in the House and Senate, could push the administration to be more aggressive and unilateral, depending on developments in the region. Such legislation, which would be intended to have a more

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significant deterrent effect than the sanctions imposed by the administration to date, may be extraterritorial in scope to include foreign persons that engage in significant transactions with certain Russian entities. Persons making business and investment decisions involving the region should be mindful that the new Congress may create a more dynamic sanctions environment in the United States than existed previously.