US and European Dynamics and the Future of Sanctions on Russia

Skadden

06/23/15

If you have any questions regarding the matters discussed in this memorandum, please contact **Eytan J. Fisch**, 202.371.7314, eytan.fisch@skadden.com or call your regular Skadden contact.

1440 New York Avenue, N.W.
Washington, D.C. 20005
202.371.7000

Four Times Square
New York, NY 10036
212.735.3000

skadden.com

Since the outbreak of the Ukraine crisis, the United States and the European Union have sought to align their sanctions responses against Russia. Indeed, this trans-Atlantic bid to leverage economic costs on Russia in response to its Ukraine policies has been the most closely coordinated sanctions effort in recent memory. While there are nuanced distinctions between the U.S. and EU measures, some of which have posed implementation challenges for the international banking and trade communities, thematically the restrictions are very similar.

Sanctions have included, among others: asset freezes of Russian government officials, officials of the former Yanukovych regime, and, as described by the U.S. Treasury Department, prominent figures of Vladimir Putin's "inner circle"; "sectoral sanctions" restricting capital markets access to key entities in Russia's financial, energy and defense sectors, as well as the provision of certain goods and services to Russia's deepwater, Arctic offshore and shale oil exploration projects; and the virtual embargo of the Crimea region.

The U.S., EU and G-7 have tied the rollback of sanctions against Russia to implementation of the Minsk agreements. However, with the situation unresolved and fighting continuing on the ground, the prospect of additional measures remains. On June 8, 2015, the G-7 leaders issued a declaration in which they stated they "stand ready to take further restrictive measures in order to increase cost on Russia should its actions so require."

Should events on the ground dictate additional measures, two factors will likely influence any new sanctions: the ability of the 28 EU member states to maintain a unified position and, if the EU can't, the willingness of the U.S. government to act unilaterally.

Considerations Likely to Shape Future Sanctions

The EU Context

Russia is by far the largest and most integrated economy ever targeted by U.S. and EU economic sanctions. In recognition of that challenge and the increased potential for negative spillover on U.S., European and other businesses, the sanctions imposed on Russia have been narrowly tailored and specifically designed to try to minimize second-order effects. Nevertheless, as with any sanctions, the imposing countries have borne certain financial and economic costs. Strains in EU unity have appeared in recent months as a result of the costs felt there and differing views among member states on issues such as the political utility of sanctions, Europe's overall economic situation and the broader security implications of Russia's actions in Ukraine.

European Council President Donald Tusk said in March 2015 that "[i]t is increasingly difficult to build European unity over the relatively tough actions, which we have to acknowledge today include maintaining sanctions." As unanimity is required among the EU's 28 member states to impose new measures — including, for example, asset freezes of additional individuals or entities under existing authorities — just a few countries can meaningfully influence the direction of the sanctions. Events on the ground can shift the balance and make it more or less politically tenable for certain countries to support or oppose a strengthened sanctions effort.

In light of the reservations of some EU member states, there was uncertainty about the EU's ability to maintain the existing sanctions on Crimea and Sevastopol and the sectoral sanctions on Russia, which were set to expire on June 23, 2015, and July 31, 2015, respectively. That question appears to have been answered. On June 17, 2015, EU ambassadors approved the extension of the Crimea and Sevastopol restrictive measures for one year and the sectoral sanctions for six months. Formal ratification by EU ministers of the Crimea and Sevastopol extension took place on June 19, 2015, and these measures are now scheduled to expire on June 23, 2016. On June 22, 2015, EU foreign ministers similarly endorsed the decision to extend the sectoral sanctions against Russia until January 31, 2016. The next EU renewal test is set for September 15, 2015, when asset freezes and travel bans against 150 individuals and 37 entities are due to expire.

The matter of EU support for additional sanctions, however, remains an open question. Statements by EU officials in the coming weeks should offer a window into the current state of EU unity and, consequently, the strength of any new sanctions measures we may be able to expect from Brussels.

The US Context

If the situation in eastern Ukraine worsens and the U.S. is ready to impose new sanctions but the EU is unable to muster support for more than "sanctions maintenance" measures (*e.g.*, additional listings of modest consequence), the U.S. government's willingness to impose strong new sanctions without the partnership of the EU will be tested. There are two components of that test. The first is the response of the executive branch, which has imposed the majority of U.S. sanctions against Russia. The second, and perhaps less obvious, is the response of Congress, which in recent years has — namely in the Iran context — not shied away from flexing sanctions muscle when it perceived the executive branch (and, at times, partner countries) to be insufficiently aggressive.

To date, Congress has passed two pieces of legislation, both signed into law by President Barack Obama, that impose certain sanctions in connection with the situation in eastern Ukraine, including measures directed at Russia. The more recent of the two, the Ukraine Freedom Support Act of 2014 (UFSA), among other things, authorizes but does not require the president to impose what are commonly referred to as "secondary sanctions" against foreign financial institutions that engage in significant transactions involving certain sanctioned parties or activities. These powerful measures are modeled on sanctions imposed by the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 and related Iran sanctions legislation.

Significantly, in signing the UFSA in December 2014, Obama stated: "At this time, the Administration does not intend to impose sanctions under this law, but the Act gives the Administration additional authorities that could be utilized, if circumstances warranted." If the Ukraine crisis deepens, some in Congress may call on the executive branch to use the tools already made available by the statutes or push for additional legislative action. How Congress responds to changing events remains a major question, the answer to which could have a significant influence on the course of U.S. sanctions on Russia.

Conclusion

Emerging from the G-7 meetings in Bavaria in early June 2015, G-7 leaders remained focused on finding a diplomatic solution to the crisis in eastern Ukraine. Yet, they made clear that they were laying the groundwork not only for the continuation of existing measures but for possible additional sanctions on Russia, if needed. In a speech in Berlin on June 22, 2015, U.S. Secretary of Defense Ash Carter said: "The best tool we have to confront Russia's aggression in Ukraine is the economic sanctions regime the United States and Europe are leading against those responsible for this unacceptable behavior. These sanctions are having an effect, and they've increased the cost Russia is paying for its aggression. … I encourage the EU to maintain solidarity and support for these sanctions as they did last week, as long as it takes to convince the Kremlin to fully implement the Minsk Agreements." Whether and how new measures take shape will depend not only on the situation on the ground in eastern Ukraine but also on the political dynamics of the EU's decision-making process and the convergence or divergence of views in the United States between the executive and legislative branches regarding the appropriate response.