

New Law Marks Significant Increase in US Sanctions on Russia, Stays the Course on Iran, North Korea

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On August 2, 2017, President Donald Trump signed into law the Countering America's Adversaries Through Sanctions Act (the Act), which significantly expands U.S. sanctions against Russia while enacting modest new sanctions on Iran and North Korea. The Russia-focused measures tighten existing sectoral sanctions and impose a host of new sanctions, including "secondary sanctions," that could significantly impact U.S. and non-U.S. companies. The Act, which passed both the Senate and the House of Representatives with overwhelming support, also imposes significant new procedural requirements on the president with respect to the easing, lifting and licensing of Russia-related sanctions.

In signing the Act, the president issued two statements that make clear his administration has fundamental concerns with the law. While President Trump stated that he was signing the Act "for the sake of national unity," he asserted that the law is "significantly flawed" and that it contains provisions that are "clearly unconstitutional" because they tread on the president's constitutional foreign affairs powers. He also stated that his administration "will give careful and respectful consideration to the preferences expressed by Congress" in the law but expressed that the executive branch will implement the sanctions "in a manner consistent with the President's constitutional authority to conduct foreign relations."

While the new measures imposed with respect to Iran and North Korea have generated only modest attention outside those countries, the new sanctions on Russia have elicited a strong response not only from Russia, which has reacted by reportedly expelling hundreds of U.S. diplomats, but also from the European Union due to concerns about the potential impact some provisions could have on European companies. Certain voices in Europe, including in Germany, have called for possible countermeasures against the new law. It will be important to monitor any European Union legal response to the sanctions.

Russia Sanctions

Codification of Existing Authorities and Expansion of Sectoral Sanctions

The Act codifies several existing executive orders, including the four Ukraine/Russia-related executive orders (13660, 13661, 13662 and 13685) and executive orders (13694 and 13757) that provide the president with the authority to impose sanctions on persons engaged in malicious cyber-related activities.

Beyond codifying these existing authorities, the Act tightens the sectoral sanctions imposed pursuant to Executive Order 13662. Under four directives issued in 2014, the Office of Foreign Assets Control (OFAC) instituted narrowly tailored prohibitions on U.S. persons and transactions within the United States with respect to identified companies in Russia's financial (Directive 1), energy (Directives 2 and 4), and defense (Directive 3) sectors, and companies in which the identified companies hold a 50 percent or greater interest. The Act does not alter Directive 3 but directs the secretary of the treasury to modify the other three directives as follows:

- **Directive 1** targets Russia's financial services sector and prohibits transactions, financing or other dealings in (i) "new" debt of longer than 30 days maturity, and (ii) "new" equity, involving companies subject to the directive. The Act directs the treasury secretary to, within 60 days, reduce the debt restriction to 14 days.
- **Directive 2** targets Russia's energy sector and prohibits transactions, financing or other dealings in "new" debt of longer than 90 days maturity, involving companies subject to the directive. The Act directs the treasury secretary to, within 60 days, reduce the debt restriction to 60 days.

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- **Directive 4** also targets Russia’s energy sector and prohibits the provision of goods, services (excluding financial services) or technology in support of deep-water, Arctic offshore, or shale oil exploration or production projects in the Russian Federation involving companies subject to the directive. The Act directs the treasury secretary to, within 90 days, expand Directive 4 to “new” deepwater, Arctic offshore, and shale oil exploration or production projects worldwide involving companies subject to the directive where the company has a “controlling interest” or a “substantial non-controlling ownership interest” in the project of 33 percent or more.

Limitations on the President’s Authority to Ease Sanctions and Issue Licenses

The Act subjects to congressional review the president’s ability to waive or terminate the application of sanctions imposed on targeted persons under the Act, any of the now-codified executive orders referenced above or certain statutes. This would include congressional review of any removals of individuals or entities from OFAC’s List of Specially Designated Nationals and Blocked Persons (SDN List) or from the Sectoral Sanctions Identifications List (SSI List).

Significantly, the Act also subjects to congressional review “any licensing action that significantly alters” U.S. foreign policy with respect to Russia, but it clarifies that “the routine issuance of a license that does not significantly alter” this policy need not be sent to Congress. Congressional review and approval of certain OFAC licenses is a departure from past precedent and raises the prospect that the licensing process could be politicized. It is also not yet clear whether this review would in practice be applied only to general licenses (broad authorizations) or would also include specific licenses (case-by-case authorizations that require an application to OFAC).

Secondary Sanctions

The Act puts “secondary sanctions” front and center in the Russia context. Secondary sanctions, which are most closely identified with U.S. sanctions on Iran, are a set of measures that principally target foreign individuals and entities for engaging in enumerated activities that may have no U.S. jurisdictional nexus. Unlike a violation of “primary sanctions,” such as the sectoral sanctions discussed above (which can result in civil or criminal penalties), a party that engages in conduct that is subject to secondary sanctions can be sanctioned by the U.S. government.

Secondary sanctions have existed in the Russia sanctions context since 2014. However, in large part due to a signing statement issued by President Barack Obama upon signing the Ukraine

Freedom Support Act in 2014 (UFSA), in which he stated that “the Administration does not intend to impose sanctions under this law,” UFSA’s discretionary secondary sanctions have to date largely been disregarded.

The Act makes mandatory certain previously discretionary secondary sanctions and enacts new mandatory and discretionary secondary sanctions. Whether mandatory (the president “shall” impose) or discretionary (the president “may” impose), each measure requires a determination by the president that a specific individual or entity has engaged in the enumerated sanctionable conduct. None of the measures is self-executing, and some include an option for the president to determine it is not in the national interest to impose the sanction.

The UFSA discretionary measures that are now mandatory include the following:

- **Investments in Special Crude Oil Projects:** Section 225 of the Act requires the president to impose sanctions on foreign persons who knowingly make a significant investment in a special Russian crude oil project. This applies to any project intended to extract crude oil from the exclusive economic zone of the Russian Federation in waters more than 500 feet deep, Russian Arctic offshore locations or shale formations in the Russian Federation. This sanction is effective 30 days after the date of enactment of the Act. Unlike the modified Directive 4, the oil projects covered by Section 225 are limited to those within Russian territory or maritime waters. When imposing sanctions, the president must select three or more from a menu of sanctions that range from the relatively minor (*e.g.*, restricting access to services provided by the Export-Import Bank of the United States) to the very severe (*e.g.*, blocking of the sanctioned person).
- **Transactions Involving Foreign Financial Institutions:** In addition to sanctions for processing certain arms-related transactions, Section 226 requires the president to impose sanctions — here, the loss of U.S. correspondent account access — on any foreign financial institution that the president determines (i) knowingly engages in “significant transactions” involving significant investment in special Russian crude oil projects by persons sanctioned for that activity, or (ii) knowingly facilitates a “significant financial transaction” on behalf of any Russian person included on OFAC’s SDN List under Executive Orders 13660, 13661, 13662 and any other executive order addressing the crisis in Ukraine. With respect to Executive Order 13662, to date, all persons sanctioned thereunder have been placed on the SSI List and not the SDN List.

The Act also provides for the new mandatory and discretionary secondary sanctions that include the following:

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- Significant Transactions Involving Sanctioned Persons:

Although by its title Section 228 appears only intended to target those that engage with “foreign sanctions evaders and serious human rights abusers,” its text reads much more broadly. Among its measures, Section 228 requires the president to impose sanctions on a “foreign person” the president determines knowingly (i) materially violates — or attempts, conspires or causes a violation of — any license, order, regulation or prohibition contained in specific Ukraine/Russia-related executive orders or statutes, or (ii) “facilitates a significant transaction or transactions, including deceptive or structured transactions, for or on behalf of ... any person subject to sanctions imposed by the United States with respect to the Russian Federation”, or any child, spouse, parent or sibling thereof. The sanction for engaging in the proscribed conduct is a blocking (*i.e.*, asset freeze and transaction ban).

There are a number of definitional considerations and questions that arise in Section 228. For example, the definition used for “foreign person” is unusual and includes “any entity not organized solely under the laws of the United States, or existing solely in the United States,”¹ which has the potential to be much broader than the traditional definition of an individual or entity that is not a U.S. person. Second, the term “person subject to sanctions” could potentially include persons on the SDN List as well as persons on the SSI List, as the U.S. government has imposed some level of sanction on each. Were SSI List entities to be captured, this provision could, in effect, swallow the more narrowly tailored sectoral sanctions. We anticipate that OFAC will issue clarifying guidance on Section 228, among other provisions, as it determines its implementation approach to the Act.

- Significant Transactions With the Russian Defense and Intelligence Sectors:

Section 231 of the Act requires the president, on or after 180 days after enactment, to impose five or more from a menu of sanctions on any person (including non-U.S. persons) the president determines “knowingly [...] engages in a significant transaction with a person that is part of, or operates on behalf of, the defense or intelligence sectors of the Government of the Russian Federation.”

No later than 60 days after the date of enactment, the president is required to issue regulations or other guidance that will “specify the persons that are part of or operating on behalf of the defense and intelligence sectors of the Government of the Russian Federation.” Therefore, it appears likely that OFAC will entertain a list-based approach to the persons in the defense and intelligence sectors that can trigger sanctionable conduct. At a minimum, that list would appear to include the

Main Intelligence Agency of the General Staff of the Armed Forces and the Federal Security Service, both of which are identified in Section 231.

- **Privatization of State-Owned Russian Assets:** Section 233 requires the president to impose five or more from a menu of sanctions on persons determined by the president to have, with actual knowledge, made an investment greater than \$10 million (or a combination of investments of \$1 million or more that total \$10 million in any 12-month period) — or facilitated such an investment — if the investment directly and significantly contributes to the ability of the Russian federation to privatize state-owned assets in a manner that “unjustly benefits” Russian government officials or their close associates or family members.
- **Russian Energy Export Pipelines:** Section 232, a discretionary sanction, authorizes — but does not require — the president to impose, “in coordination with allies of the United States,” five or more sanctions from a menu of sanctions on any person that knowingly (i) makes “an investment that directly and significantly contributes to the enhancement of the ability of the Russian Federation to construct energy export pipelines”; or (ii) “sells, leases or provides to the Russian Federation, for the construction of Russian energy export pipelines” certain goods, services, technology, information, or support that (a) has a fair market value of \$1 million or more, or (b) that, during a 12-month period, have an aggregate fair market value of \$5 million or more.

Other Sanctions

In addition to the expansion of sectoral sanctions and secondary sanctions, the Act also contains additional bases for designation (*i.e.*, being added to OFAC’s SDN List):

- **Cyber-Related Sanctions:** Section 224 builds on existing cyber-related sanctions by requiring the president, after 60 days from the date of enactment, to impose sanctions against any person that the president determines knowingly engages on behalf of the Russian government in “significant activities undermining cybersecurity” directed at any person, including a democratic institution, or government. Under Section 224, the president is required to impose multiple sanctions from a menu of sanctions on persons assisting in such activities, including by providing financial services in support of such activities.
- **Significant Corruption:** Section 227 requires the president to impose sanctions on any Russian government official, or a close associate or family member of such an official, that the president determines is responsible for, or complicit in, “ordering, controlling, or otherwise directing, acts of significant corruption” in Russia or elsewhere.

¹ See 31 C.F.R. 595.304.

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- **Transfer of Arms to Syria:** Section 234 requires the president to impose sanctions on a foreign person if the president determines the foreign person has “knowingly exported, transported, or otherwise provided to Syria” certain significant financial, material or technological support that contributes to the ability of the Syrian government to acquire or develop weapons of mass destruction (WMD), ballistic or cruise missiles, or certain other significant defense articles.

Iran Sanctions

The Iran-related sanctions are largely additive to existing sanctions and are unlikely to materially impact the imposition or enforcement of U.S. sanctions related to Iran. A key question, however, is whether these sanctions will nevertheless engender a response from Iran that could put the Iran nuclear deal — the Joint Comprehensive Plan of Action (JCPOA) — at risk. The Iran sanctions in the Act include the following:

- **Ballistic Missile and WMD Sanctions:** The Act requires the president to impose blocking sanctions on any person the president determines knowingly and materially contributes to the Iranian government’s ballistic missile or WMD programs. The president has had authority to impose similar sanctions under Executive Order 13382, and both Presidents Trump and Obama have used that authority since the JCPOA took effect to impose sanctions on persons that support Iran’s ballistic missile program.
- **Enforcement of Arms Embargoes:** The Act also requires the president to impose blocking sanctions on any person the president determines knowingly and materially contributes to the supply, sale or transfer of certain military materiel (including battle tanks, armored combat vehicles, large caliber artillery systems, combat aircraft, attack helicopters, warships, missiles or missile systems) to or from Iran. Sanctions are also required to be imposed on any person the president determines provides to Iran any “technical training, financial resources or services, advice, other services or assistance” related to the sale, transfer or use of such arms and related materiel.
- **IRGC Terrorism Designation:** The Act requires the president to designate the Islamic Revolutionary Guard Corps (IRGC) as a terrorist-supporting entity under Executive Order 13224. Such a designation will have little tangible legal effect, as the IRGC is already designated under WMD- and human rights-related sanctions authorities. Additionally, even after the start of implementation of the JCPOA, significant transactions with the IRGC have continued to subject non-U.S. persons to potential secondary sanctions.

North Korea Sanctions

North Korea sanctions were a late addition to the Act and followed a North Korean intercontinental ballistic missile test

on July 4, 2017. The Act’s North Korea-focused sanctions principally serve to expand the categories of activities set out in the North Korea Sanctions and Policy Enhancement Act of 2016 (NKSPEA) that could result in an OFAC designation.

As a result of these sanctions, the president is required to designate persons who the president determines engage in a variety of activities, including purchasing or acquiring from North Korea gold, titanium ore, vanadium ore, copper, silver, nickel, zinc or rare earth minerals; selling or transferring to North Korea any significant amounts of rocket, aviation or jet fuel (except for use by civilian aircraft outside North Korea); providing fuel, supplies or bunkering services for designated North Korean vessels or aircraft; providing insurance or registration services to a vessel owned or controlled by the North Korean government; and maintaining a correspondent account with a North Korean financial institution.

The Act also increases the president’s discretionary sanctions authority under NKSPEA and authorizes the president to designate persons who knowingly engage in a range of activities, including purchasing or acquiring significant quantities of coal, iron or iron ore from the North Korean government; purchasing or acquiring significant types or amounts of textiles or agricultural products from the North Korean government; purchasing significant amounts of petroleum products or natural gas resources to the North Korean government; engaging in, facilitating or being responsible for the online commercial activities of the North Korean government, including online gambling; purchasing or otherwise acquiring fishing rights from the North Korean government; and engaging in, facilitating or being responsible for the exportation of workers from North Korea.

Mirroring the action taken by the Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) under Section 311 of the USA PATRIOT Act in 2016, the Act prohibits U.S. financial institutions from allowing foreign financial institutions to use correspondent accounts to provide significant financial services indirectly to certain persons, foreign governments or financial institutions designated under the NKSPEA.

While the Act does not alter the model of sanctions that the U.S. has imposed with respect to North Korea, it does expand the criteria that OFAC can use to sanction parties dealing with North Korea. With several recent rounds of U.S. sanctions targeting individuals and entities in China, we would expect Chinese companies to be a particular focus of U.S. authorities as they determine how to use these new authorities.

Associates Ondrej Chvosta, James E. Perry, Innokenty Pyetranker and Ashton M. Simmons assisted in the preparation of this memorandum.