

Russia Sanctions Outlook: Potentially Imminent and Far-Reaching Changes

With over 100,000 Russian troops now on the Ukrainian border and tensions rising, the Biden Administration is preparing a response to a possible Russian invasion of Ukraine. With little to no domestic appetite in the U.S. for a military solution, and Russian leader Vladimir Putin's long record of imperviousness to "soft" diplomatic measures, economic sanctions are the one substantial tool left in the Biden Administration's belt.

U.S. Administration officials have not been shy about openly discussing "broad" and "sweeping" sanctions designed to cripple the Russian economy, using the threat as a deterrent to a Russian invasion.

Moreover, NATO allies are also discussing tougher sanctions, and there are reports that the European Union (EU) is considering cutting off Russia's access from the SWIFT international financial messaging system.

This client alert addresses (1) the speed with which sanctions could be imposed; (2) what those sanctions may look like; and (3) certain steps companies should consider given the current uncertainty.

Sanctions can be imposed quickly

The International Emergency Economic Powers Act ("IEEPA"), 50 U.S.C. §§ 1701 – 1706, grants President Biden broad authority to declare a national emergency with respect to foreign threats to national security, foreign policy, or economy of the U.S. that are "unusual or extraordinary." Pursuant to § 1702, the President may issue an Executive Order imposing new sanctions on Russia if it invades Ukraine. As a result, Biden can impose such sanctions unilaterally without congressional action, and it is likely that the Administration already has Executive Orders in place, ready for execution upon any Russian move seen as a provocation. In short, the Administration could implement sanctions within hours of a Russian invasion. Once issued, such Executive Orders can remain in effect until they are revoked, canceled, expire, or are adjudicated unlawful.

IEEPA sanctions are typically administered civilly by the Department of the Treasury's Office of Foreign Assets Control ("OFAC"), which has continually phased in Ukraine-related sanctions regulations since 2014. OFAC often issues regulations codifying or otherwise incorporating Executive Orders and can name individuals and entities to its list of Specially Designated Nationals and Blocked Persons (the "SDN List"), which can prohibit U.S. persons from engaging in most business with such entities and require them to block the assets of such entities should they come under the U.S. person's possession. When new regulations or restrictions are implemented, OFAC can issue a "general license" – a broad authority enabling U.S. persons or others a typically brief window to wind-down ongoing activities that the agency's latest actions prohibit. OFAC also administers licensing regimes by which U.S. persons and others can obtain specific authorization to engage in transactions prohibited by sanctions.

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The Biden Administration can leverage OFAC proactively in three distinct ways – (1) adding more Russian nationals and entities to the SDN List, (2) implementing new regulations, which can, but do not necessarily have to, follow new Executive Orders, and may instead be issued pursuant to authorities of already existing Executive Orders and legislation, and (3) more tightly enforcing those regulations already in place.

What the Russian sanctions could look like

It is difficult to predict what sanctions may be imposed, but sanctions on other countries, such as China and Iran, as well as currently proposed legislation, can provide a useful roadmap. Senate Democrats have proposed a bill – H.R. 6470 (the “Defending Ukraine Sovereignty Act of 2022”) -- which calls for increased aid to Ukraine and sanctions against Russia if the crisis escalates. This proposal includes sweeping sanctions on senior government and military officials, banking institutions, Russian companies using securing messaging systems such as SWIFT, and even Putin himself. With respect to prior sanctions, the Trump Administration’s sanctions on the Chinese technology sector and the Obama Administration’s sanctions on Iran’s oil and gas exports may provide some guidance.

1. Banking & Finance

As mentioned above, one oft-discussed retaliatory measure against Russia would be to sever the country’s access to the SWIFT financial messaging system, a means by which banks move funds around the globe daily. H.R. 6470 places particular emphasis on this. Punitive measures can include blocking property transactions in which targeted individuals or entities have interests, as well as similar measures against non-Russian entities providing, enabling, or facilitating SWIFT access to such targeted Russian financial institutions, including those acting as intermediaries.

2. Natural Resource “Extractive Industries”

H.R. 6470 is substantially broader than previous measures regulating Russia’s energy sector, impacting not only those areas, but also coal, minerals, and potentially other sectors. The proposed bill would drastically limit Russia’s ability to extract and export its energy resources, including via the Nord Stream 2 pipeline that is planned to deliver Russian gas to Europe. These measures can enable OFAC to block virtually any party involved in the planning, building, and operation of the pipeline, including individual corporate officers, effectively prohibiting them from most dealings with U.S. persons and blocking any of their assets entering the U.S. or being transferred to U.S. persons. The bill also includes provisions to allow for the U.S. to use any measures necessary to prevent Nord Stream 2 from becoming operational.

3. Export Control Changes

The Biden Administration could also follow its predecessor in broadening the Foreign Direct Product Rule (“FDPR”) in the Export Administration Regulation (“EAR”), a body of regulations governing the international transfer of U.S. origin goods and technologies. This rule expands the EAR’s jurisdiction to include many sensitive technologies produced outside the U.S. using technology or plants that originated in the U.S. The broadening of the FDPR was critical in the Trump Administration’s efforts to clamp down on access to U.S. silicon wafer and semiconductor technology by China’s Huawei and its affiliated entities. A similar move is now being proposed that could impact a host of key U.S. technologies Russia relies on, limiting access not only to items produced in the U.S., but even to derivative technologies produced elsewhere. Such a move would prove detrimental to Russia’s access to this technology for military and commercial purposes, particularly given Russia’s lack of equivalent prowess in these spaces. It could also limit the country’s ability to import technologies such as smartphones as well as automotive and aircraft equipment.

4. Secondary Sanctions

Beyond primary sanctions on Russian individuals and entities, the Biden Administration could also impose “secondary sanctions,” akin to the framework presently in place against Iran, which seek to use the power of the U.S. market to dissuade foreign companies from doing business with Russia. While primary sanctions can impact the activities of U.S. entities dealing with Russia and place Russian parties onto the SDN List, secondary sanctions impose punitive measures on third country entities engaging in certain business sectors in Russia, usually in the form of limitations on their activities in or with the U.S.

5. Potential Punitive Measures

H.R. 6470 also calls for the restrictions on designated parties’ asset transfers of both currency and property in and through the U.S. visa bans on designated individuals, and general reporting. These punitive measures often have the effect of chilling activity generally, causing companies to engage in substantial “derisking” of activities in and with the sanctioned target more severely than required by law.

What companies should be considering now

Given the speed with which the hostilities between the U.S. and Russia could escalate and impact international finance and trade, U.S. and non-U.S. companies should be thinking proactively about the following:

- What ongoing direct or indirect transactions or contracts does the business have with Russian counterparties?
- What financial relationships does the business have with Russian financial institutions, both private and state-owned?
- To the extent that the business has commercial entanglements in Russia or with Russian counterparties, can it unwind such relationships, and, if so, how quickly?
- If certain relationships are difficult to unwind, should the business apply for an OFAC license enabling more time for the unwinding?
- Will the business’ supply chain be affected by sanctions? If so, how will the company secure items in the supply chain from substitute suppliers?

- What disclosures must be made regarding business with Russia or financing from Russian financial institutions?

Conclusion

In addition to the already existing sanctions on Russia, an invasion of Ukraine will almost certainly be met with significant measures having substantial effects on various sectors and affect many U.S. and non-U.S. businesses and individuals. These sanctions will likely be imposed very quickly and may be springboards for future action. It is therefore critical that companies plan proactively, carefully considering their touchpoints with Russia and preemptively devising strategies enabling them to move swiftly and thoughtfully should the need arise.

To the extent general licenses are issued, they should be utilized where applicable. If more time is needed, a specific license should be considered, as OFAC may be more responsive to a timely request than one that is filed after the prescribed wind-down has lapsed.



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