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March 1, 2022



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Past Issues

Russian-Ukraine Conflict: Continue to Prepare for the Impact on Global Supply Chain

By Brett W. Johnson and Mary Colleen Fowler

As the Russian-Ukraine conflict continues to elicit intensifying economic responses from multiple countries, the frequency and rapidity of these new sanctions have left companies scrambling to align their internal and external international trade controls. If your company has ties to Russia or Ukraine, whether directly or via third-party countries, it may be impacted by sanctions and require compliance evaluations of ongoing and new business opportunities.

As with any additional international trade sanctions, there are constant updates and revisions related to authorized and prohibited actions. Companies should keep abreast of the changes and ensure operational adaptation to the new regulatory frameworks. Below are key developments in the recent sanctions and their impact on companies in light of the ongoing Russian-Ukraine conflict.

U.S. Announced Sanctions

- **Executive Order 14065.** EO 14065 imposes sanctions on the separatist Ukraine regions of the Donetsk People's Republic and Luhansk People's Republic. Sanctions, effective immediately, prohibited U.S. persons and entities from making investments, imports, or exports to the Donetsk and Luhansk regions.
- **Nord Stream 2 Pipeline.** The Biden Administration announced placement of the Nord Stream 2 pipeline on the Specially Designated Nationals and Blocked Persons List (the SDN List). U.S. companies have until **March 2, 2022** to wind-down transactions under General License 4.¹
- **SWIFT Action.** The U.S. and other countries are working to remove select banks from the Society for Worldwide Interbank Financial Telecommunication ("SWIFT"), which is based in Belgium and subject to EU laws, and inhibits the Russian Federation's ability to clear money payments. The U.S. and the EU continue to work to finalize the list of banks that will be cut off from the SWIFT system.
- **Foreign Reserves.** The Central Bank of Russia is inhibited from liquidating assets that would provide access to Russia's international reserves valued at around \$650 billion.

The announcement also prohibits any transactions with the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the Russian Federation.²

- **Sovereign Debt Restrictions.** The Office of Foreign Asset Control (“OFAC”) issued Directive 3 under Executive Order 14024³ forbidding U.S. persons from providing new debt or equity to multiple Russian state-owned entities, such as Sberbank. Additionally, OFAC expanded on this Directive by prohibiting U.S. financial institutions from participating in secondary market bonds issued by the Central Bank of Russia, the National Wealth Fund of Russia or the Ministry of Finance of Russia after March 1, 2022.

OFAC Additional Regulations

- **SDN List.** On February 23, 2022, OFAC announced designations to the Specially Designated Nationals and Blocked Persons List (“SDN List”). The SDN List included the following individuals and financial institutions: Members of the Russian elite; Vnesheconombank (“VEB”), Promsvyazbank (“PSB”), and 42 of their subsidiaries; Otkritie and Novikombank, and their subsidiaries; and VTB Bank PJSC, Russia’s second largest financial institution, along with 20 of its subsidiaries. Companies must comply immediately respecting individuals on the SDN list, but have until March 26, 2022 to wind-down transactions with the financial institutions on the SDN List.
- **Energy Transaction Payments.** OFAC issued multiple general licenses allowing select energy transactions payments through June 24, 2022 with VEB, VTB and Otkritie.

In general, U.S. persons, wherever located, cannot conduct transactions with designees on the SDN List. The designation requires that U.S. persons block any property belonging to SDN List designee that is in or comes into U.S. possession. Additionally, U.S. persons must comply with OFAC’s 50 percent ownership rule, meaning persons cannot conduct transactions with businesses in which one of the SDN designees has a 50 percent ownership. This requirement has significant impact on branch offices and subsidiaries located in foreign countries. Just because the action is not taken by U.S. persons from the U.S., the regulations may still apply.

- **Correspondent and Payable-Through Restrictions.** OFAC announced separate sanctions for Russia’s largest bank, Sberbank, requiring U.S. banks to terminate correspondent and payable-through account by **March 26, 2022**.

U.S. Custom’s Bureau of Industry and Security (BIS) Export Control Restrictions⁴

- **Technology Blocked.** The U.S. seeks to prevent Russia’s access to cutting-edge technology, including “Russia-wide restrictions on semiconductors, telecommunication, encryption security, lasers, sensors, navigation, avionics, and maritime technologies” to limit its military prowess.⁵ Limited licenses will be available, but the general policy will be denial. Potential exceptions include flight safety, maritime safety, humanitarian needs, government space cooperation, civil telecommunications infrastructure, government-to-government activities and support of limited operations of partner country companies in Russia.
- **Restricted License Exceptions.** BIS severely restricted availability of license exceptions for Russia exports, re-exports and in-country transfers.

- **Military End-User Rule.** Russia, already subject to the EAR's Military End-User / End-Use ("MEU") Rule, now is subject to more restrictive control concerning the export, reexport or transfer of all "items subject to the EAR." Limited exceptions exist for items designated as food and medicine under EAR99 and mass-market hardware and software as long as not provided for government end users. However, other common items – including commercial items – are not restricted and companies should ensure proper classification of their goods and services before export to Russia. In addition, companies may want to consider increased utilization of end-use statements or other compliance certifications from customers, distributors, or resellers wherever located.
- **New Foreign Direct Product Rules.** BIS implemented two new foreign direct product rules, which will greatly limit the Russian Federation's access to foreign-made products that are the direct product of U.S. software or technology. This means foreign-made products produced with or that incorporate U.S. technology or software will fall under the EAR and be subject to its export license requirements.

The Russian Response

- **The Value of the Ruble Diminishes.** Following the global announcement to remove Russia from SWIFT and cut off its external reserves, the Ruble (Russia's currency) lost a quarter of its value, prompting individuals to withdraw their savings and expose the country to a run on its banks. The Russian stock exchange remains closed in the meantime to slow the flow of money out of the country.
- **Broker Ban.** As of March 1, 2022, Russian brokers cannot sell Russian securities owned by foreigners. Additionally, Russia banned foreign cash exchange loans and transfers and will require exporters to buy the currency.
- **Sanctions in Flight.** To retaliate, Russia closed its airspace to 36 countries, including the entire EU. The flight ban will force airlines to find new routes and is expected to greatly impact the airline system.

Snell & Wilmer will continue to follow developments in the Russian-Ukraine conflict. To better understand the impact of the ever-changing economic sanctions, companies should consider reaching out to legal counsel, review and adapt existing policies and procedures, and understand contract performance obligations, including force majeure, choice of law, and dispute provisions. Importantly, companies should continue to keep up with new sanctions and Russian responses as the global supply system is impacted.

Notes:

¹ General licent four available at https://home.treasury.gov/system/files/126/peesa_gl4.pdf. [back]

² See Directive 4 Under Executive Order 14024 available at https://home.treasury.gov/system/files/126/eo14024_directive_4_02282022.pdf. [back]

³ https://home.treasury.gov/system/files/126/new_debt_and_equity_directive_3.pdf [back]

⁴ BIS Fact sheet available at <https://www.commerce.gov/news/fact-sheets/2022/02/us-department-commerce-bureau-industry-and-security-russia-rule-fact-sheet>. [back]

⁵ <https://home.treasury.gov/news/press-releases/jy0608> [back]



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