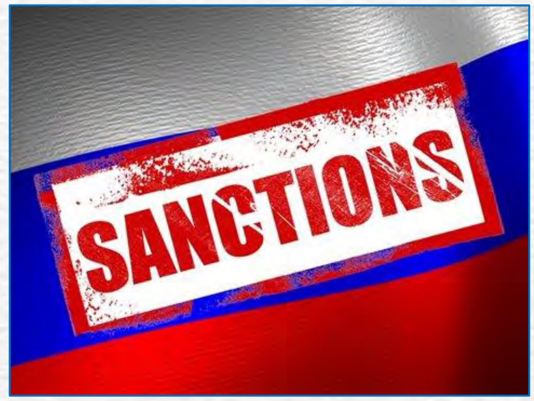


# U.S. sanctions on Russian officials & companies – Enhanced Due Diligence

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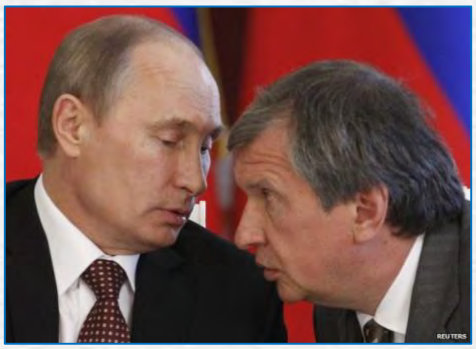

This white paper assesses the implications of Russia's activities in relation to Ukraine, particularly its invasion and support of the Eastern Ukraine local 'separatists' coupled with the shooting down of Malaysian Airlines Flight MH17. It explains effect of sanctions, imposed by the US and the EU. And it explains some of the implications of sanctions for companies. In addition, it provides guidance about what corporate mitigation programs are needed to ensure compliance with the sanctions and explains a process offered by CVG Strategy. The enhanced due diligence requirements imposed by these sanctions are considerable. Especially the 50% ownership rule which, if violated, can cause civil and criminal sanctions against American companies and U.S. Persons.

## CONSULTANCY & EXPERIENCE

CVG Strategy, LLC specializes in assisting companies with capitalizing on opportunities in government contracting and enhancing business performance. CVG Strategy is an SBA 8(a) Certified Disadvantaged Minority and Woman-Owned Small Business. Major subject matter practice areas include MIL-STD-810 Defense Program Support, ITAR & Export Compliance Training and Programs as well as Quality Management Systems.

## ATTORNEYS & LEGAL EXPERIENCE

Arcadier & Associates, P.A. is dedicated to representing clients with diverse legal needs including ITAR, export compliance, business law, and employment law. Its lawyers are respected by court officials, judges, legal peers and opposing counsel for their professionalism and efficiency. The Law Firm is AV rated by Martindale Hubbell, and Maurice Arcadier, is board certified in employment law.

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## PRACTICE & PARTNERSHIP

Government compliance, particularly in the Defense Related Industry, requires expertise and experience not easily found in one place. Together CVG Strategy, LLC and Arcadier & Associates, P.A., provide a complete Defense Industry compliance and consulting package which includes everything from initial registration, classifications, to litigation or mitigation if necessary, to provide the best solutions for their clients.

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## Why Sanctions?

It is in the news often now about Russia sponsoring an armed insurgency in Eastern Ukraine, using its Special Forces and intelligence agencies and acting through local 'separatists'. The United States Government has responded with U.S. Department of Treasury Office of Foreign Assets Control (OFAC) Sanctions. These OFAC Sanctions are prohibitions that apply to <u>all U.S. Companies</u>. They are in the form of a list of very specific individuals and companies known as Specially Designated Nationals (SDN). President Obama has authorized the Secretary of the Treasury, in consultation with the Secretary of State, to impose sanctions on named officials of the Russian government, any individual or entity that operates in the Russian arms industry, and any designated individual or entity that acts on behalf of, or that provides material or other support to, any senior Russian government official.

## Implications

The risk imposed by these sanctions for the companies is significant. In particular is the concern as to what corporate activities and programs are needed to ensure compliance. Company policy should also focus on how to identify the broader risks that are likely to arise as a result of continuing tension and crisis. It is important to recognize from the onset that the sanctions against Russia are significantly different from those imposed on Iran and are less direct and more complex to manage. For example, the sanctions do not target Russia's energy exports, but introduce complexities for large foreign energy companies, like Total, BP, Statoil and ExxonMobil, which all have significant investments and joint ventures in Russia. They will be able to operate with Russian firms, such as Rosneft, but will not be able to facilitate financing or technology transfer. Difficulties are also likely to arise with regard to pre-payment deals, whereby development loans are repaid from the promise of future energy supplies.

The recent huge cyberattack on JPMorgan Chase that touched more than 83 million households and businesses was one of the most serious computer intrusions into an American corporation. The hackers are thought to be operating from Russia and appear to have at least loose connections with officials of the Russian government.

## Compliance

In order to comply with the range of sanctions, institutions must carefully examine and observe the measures that have been progressively issued by the US and the EU since the beginning of the crisis in Ukraine.

The travel bans and asset freezes on designated individuals have given way to more systemic sanctions of major Russian banks and to targeted measures designed to increase the costs and inconvenience of doing business for a range of financial institutions, individual regime supporters, defense manufacturers and energy companies.

As a whole, these measures are designed to apply pressure to key elements of the Russian economy, while minimizing the impact on the financial and economic interests of the U.S. and the EU. Critically, the newest measures mean that Russia's access to U.S. and EU capital markets will be severely constrained; new contracts to trade in armaments will be banned and dual-use goods (those that could also be used for military purposes) are proscribed, together with technology and financing for deep-water oil and gas exploration. More individuals associated with the regime and its policies have been subjected to asset freezes and travel bans.

The principal U.S. measures prohibit the provision of financing to two major Russian banks: Gazprombank (the financial section of Gazprom) and Vnesheconombank, or VEB, a state-owned entity. Similar sanctions have been applied to the oil producer Rosneft, and natural gas supplier Novatek.

The U.S. sanctions also affect some of Russia's richest businessmen, including President Putin's inner circle. Among them is Gennady Timchenko, a founder of the commodity trading firm Gunvor. He owns Volga Group, an investment firm with stakes in energy, transport and infrastructure, as well as Novatek, Russia's second biggest gas producer.

Igor Sechin is another notorious name on the U.S. list. He is a former intelligence officer and long-term ally of Mr. Putin, the most prominent of the inner circle figures who influence Kremlin policy. Mr. Sechin is chairman of oil firm Rosneft, which has energy partnerships with ExxonMobil and the UK's BP.

More U.S. restrictions came in September, targeting the defense conglomerate Rostec, Gazprom and some other major players in the Russian economy. Their access to long-term loans has been blocked. Like the EU, the U.S. has banned exports of services and technology to Russian state oil firms engaged in Arctic and deep-water exploration. The famous Kalashnikov arms firm is there too, as are the unrecognized, self-styled "people's republics" established by the separatists in Ukraine's Donetsk and Luhansk regions.


## U.S. Sectoral Sanctions (SSI)

On July 15, 2014 the US Treasury's OFAC introduced a new list called the Sectoral Sanctions Identifications List to identify persons operating in sectors of the Russian economy identified by the Secretary of the Treasury pursuant to Executive Order 13662. Directives found within the list describe prohibitions on dealings with the persons identified. On August 14, 2014, OFAC issued the Revised Guidance on Entities Owned by Persons Whose Property and Interests in Property are blocked, which sets forth new guidance on companies owned 50 percent or more in the aggregate by more than one blocked person (SDN or SSI). This means that if a U.S. Company transacts business with a company owned in aggregate 50% or more by blocked persons they are in violation of these sanctions and subject to fines and penalties.

## Risk

Clearly, those institutions wishing to remain compliant with regard to the full range of sanctions will need to differentiate between the two different sanctions regimes (U.S. and EU), to ensure that they understand the subtle differences and what is prohibited or permissible in each case. Multi-nationals will especially need to consider the liabilities of their partners and subsidiaries in terms of sector engagement, national law and geographic footprint. In addition, it will be essential to monitor capital flows, track the activities of blocked individuals (and their associated networks) and remain familiar with evolving applications of sanctions to ensure that both direct and indirect risks are minimized and that reputational and commercial integrity is preserved.

As the situation develops, companies and financial institutions need to examine in detail the effects of U.S. and EU sanctions on their dealings with Russian companies and institutions. The sanctions are complicated in their application, not only because the U.S. and the EU have sought to increase pressure on Russia progressively, but also because out of self-interest, they have allowed some limited alternatives. The U.S. has excluded Russia's largest bank, Sberbank, from the proscribed list and most of the bans on technology transfer apply to the oil sector, leaving the gas industry untouched (Europe's dependence on Russian gas) and unaffected.

Interestingly, defense restrictions apply to future contracts and not existing contracts. Therefore, France may proceed to supply the powerful Mistral-class amphibious ships to the Russian Navy. Another complicating factor is that, apart from the U.S. and EU countries, very few other states have backed the sanctions. Australia, Japan and South Korea have all explicitly said that they will not impose sanctions, while the other leading economies, including India and China, have chosen to retain their existing links with Russia.

All U.S. Companies, including multinationals in particular, need to be aware of the differing applications established by U.S. and EU sanctions. There are also several potential pitfalls with regard to dual use technologies (ITAR and EAR Restricted) and other products, which bring an export control risk, and in relation to donations to NGOs and charities.

**U.S. persons**, ***[Natural Born or Naturalized U.S. Citizens, Legal Permanent Residents (green card holder) or U.S. Chartered Corporations]***, are advised to act with caution when considering a transaction with a non-blocked entity in which one or more blocked persons has a **significant ownership interest that is less than 50 percent or which one or more blocked persons may control by means other than a majority ownership interes**t. Such entities may be the subject of future designation or enforcement action by OFAC. Furthermore, a U.S. person (company or individual) may not procure goods, services, or technology from, or engage in transactions with, a blocked person directly or indirectly (including through a third-party intermediary).

While sanctions and restrictions on activities with Russian individuals and institutions remain in place, companies that wish to be compliant with their home or host governments' policies will need to be very diligent in their business ventures and transactions with regard to Russia. They will require access to forensic skill and vigilance in detecting and exposing not only direct attempts by Russian organizations to acquire capital and investment, but also indirect methods of operation involving third parties, shell companies and informal networks.

These will necessarily include criminal and non-compliant business links, some with connections to legitimate government activity and sovereign wealth management authorities. The complex interplay of named individuals, the targeted banks and companies and the involvement of the Russian state all make the tracking of interests and connections difficult without a systemic analysis and coherent assessment of how all these entities and individuals relate

## Facilitation

1. In addition to prohibiting direct transactions by U.S. Persons with the sanctioned persons/entities, U.S. Persons are prohibited from financing, guaranteeing, approving, or otherwise facilitating non-US Person transactions with SDNs.
2. ***If you cannot do it yourself, you cannot help someone else do it!***
3. US Persons working for, or serving on the Boards of, foreign companies must affirmatively recuse themselves from any matter involving SDNs and cannot refer an SDN matter to a non-US Person in their companies for handling/processing.
4. Records of foreign entity transactions with SDNs should not be maintained in the United States.

## Transactions and Ownership / Control

1. If a named SDN owns 50%, or more, of an entity, directly or indirectly, that entity is also blocked automatically, even if not specifically named as an SDN.
2. US Persons need to check to see if an entity with which they are dealing is 50%, or more, owned by an SDN.
3. This can be tricky, as ownership interests are not always easily evident. The level of due diligence to be performed generally should be based on the particular risks in the transaction, and the nature of the relationship being reviewed, e.g., due diligence for direct customers should be higher than for indirect parties to a transaction.
4. SDN "control" without 50%, or more, ownership does not result in automatic blocking, but could result in OFAC designating the controlled entity as an SDN.

## Mitigation

Proving ownership and control to ensure that SDNs or SSIs do not have aggregate 50% or more ownership including direct or indirect control is very challenging for U.S. Companies. Essentially U.S. Sanctions require that you know your customer, know your customer's customer and have documented evidence to prove compliance with these regulations.

## Enhanced Due Diligence Program

CVG Strategy's Enhanced Due Diligence 11 Step Program is the solution for companies wishing to comply with the law while continuing to conduct business with entities and institutions owned, connected to, or suspected of having connections with the Russian Federation. Our process is focused on verification of ownership and control with deliverables that will serve as a due diligence record for our clients. Russian Linguists have been retained for this program, and the English language deliverables include certified translations from Cyrillic.

Partnered with Arcadier & Associates, a law firm specializing in export compliance, CVG Strategy's Enhanced Due Diligence 11 Step Program (for each entity) is the best solution available. By applying the process to each company (customer or vendor) it is the best assurance our clients have the correct information to support proceeding with the transaction or putting it on hold to apply for a license from OFAC.

The process is considered the protected intellectual property of CVG Strategy, LLC and may be reviewed with potential clients under a non-disclosure agreement.

Contact Kevin M. Gholston, Vice President of CVG Strategy, at 321-253-9791 or kgholston@cvgstrategy.com for more information.

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