

Memorandum

U.S. Sanctions and Export Controls in Response to Ukraine Crisis

February 28, 2022

Over the course of the last week, the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") and the U.S. Department of Commerce's Bureau of Industry and Security ("BIS") announced a package of new sanctions and export controls against Russia and its allies in response to the Ukraine crisis.¹ The U.S. sanctions to date have targeted the separatist regions of Ukraine, major Russian financial institutions, Russian and Belarusian elites, including Putin himself, and various Russian and Belarusian firms. Clients should review their exposure to Russia, Ukraine, and Belarus and individuals and entities from those jurisdictions in light of this week's developments.

Sanctions and export controls in response to the Ukraine conflict may evolve rapidly and further sanctions and restrictions may be forthcoming, as the crisis unfolds. For example, the U.S. and allied nations issued a joint statement on February 26, 2022 committing to remove certain Russian banks from the Society for Worldwide Interbank Financial Telecommunication ("SWIFT"), to impose further sanctions on the Russian Central Bank, and to further target individuals and entities which facilitate the war in Ukraine and harmful activities of the Russian government. This memo reflects the state of the law as of February 26, 2022 and Simpson Thacher is actively monitoring the situation.

The sanctions and export control actions announced this week include:

1. Comprehensive, territory-wide sanctions relating to the self-described Donetsk People's Republic ("DNR") and Luhansk People's Republic ("LNR");
2. Blocking sanctions against Russian financial institutions (including Corporation Bank for Development and Foreign Economic Affairs Vnesheconombank ("VEB"), Joint Stock Commercial Bank Novikombank ("Novikombank"), Open Joint Stock Company Sovcombank ("Sovcombank"), Promsvyazbank Public Joint Stock Company ("PSB"), Public Joint Stock Company Bank Financial Corporation Otkritie ("Otkritie"), VTB Bank Public Joint Stock Company ("VTB Bank"), their subsidiaries and certain vessels, and correspondent and payable-through account sanctions on Sberbank;
3. Restrictions on dealings in sovereign debt and dealings in new debt or equity in certain state-owned and privately owned entities;

¹ Note that the EU, U.K., and other allied nations have taken similar measures in response to the Ukraine crisis.

4. Blocking sanctions related to the Nord Stream 2 pipeline;
5. Blocking sanctions against certain Russian and Belarusian elites;
6. Blocking sanctions against Belarus's defense sector and financial institutions; and
7. Enhanced export controls targeting Russia, Russian firms, and the separatist regions in Ukraine, which are described in detail below.

Two new executive orders—Executive Order (“E.O.”) 14024 and E.O. 14065—were issued this week and additional sanctions were issued pursuant to two previously issued executive orders, E.O. 14038 and E.O. 14039. The new U.S. economic sanctions were implemented through these four executive orders and related directives issued by OFAC, as described in further detail below. Additionally, BIS issued a final rule, Implementation of Sanctions Against Russia Under the Export Administration Regulations, which implements stricter export controls concerning Russia under the U.S. Export Administration Regulations (“EAR”), in order to protect U.S. national security and foreign policy interests. BIS’ final rule implements new Russia license requirements for a variety of items that were not previously controlled to Russia including microelectronics, telecommunications items, sensors, navigation equipment, avionics, marine equipment, aircraft components, and licensing policies, including a policy of denial, to protect U.S. national security and foreign policy interests. Of particular note for non-U.S. persons, is the inclusion of two new foreign direct product rules which allow BIS to establish control over certain foreign-produced items that are made outside of the United States using certain U.S.-origin software or technology.

Territorial Sanctions

The President issued E.O. 14065 on the evening of February 21, 2022. E.O. 14065 effectively imposes comprehensive, territory-wide sanctions on the self-described DNR or LNR territories. Note that E.O. 14065 defines the term “Covered Regions” to include not only the DNR and LNR, but also “other regions of Ukraine as may be determined by the Secretary of the Treasury, in consultation with the Secretary of State.” As such, the territory subject to these prohibitions could potentially expand over time. U.S. persons should now treat the DNR and LNR as comprehensively embargoed territories, similar to the current treatment of Crimea. Non-U.S. persons found to have operated in the DNR or LNR territories may also themselves be sanctioned.

E.O. 14065 prohibits:

- The making of new investments in the Covered Regions by a United States person, wherever located;
- The importation into the United States, directly or indirectly, of any goods, services, or technology from the Covered Regions;
- The exportation, sale, or supply, directly or indirectly, from the United States, or by a United States person, wherever located, of any goods, services, or technology to the Covered Regions; and

- Any approval, financing, facilitation, or guarantee by a United States person, wherever located, of a transaction by a foreign person where the transaction by that foreign person would be prohibited if performed by a United States person or within the United States.

There are several general licenses issued in connection with E.O. 14065 including Ukraine General Licenses 17-18, which authorize a range of conduct including certain transactions related to agricultural commodities, medical devices, and certain other humanitarian-related activities concerning the DNR and LNR. Most notably, Ukraine General License 17 authorizes the wind-down of transactions, including those that are ordinarily incident and necessary to the wind-down of transactions involving DNR and LNR, until March 23, 2022.

Blocking Sanctions Against Russian Financial Institutions and Correspondent and Payable-Through Account Sanctions on Sberbank

Over the past week, the U.S. government targeted several of the major Russian financial institutions and the following Russian banks² have been designated as Specially Designated Nationals (“SDNs”): Novikombank, Otkritie, PSB, Sovcombank, VEB, VTB Bank.

All entities owned 50 percent or more, directly or indirectly, by the foregoing entities or other SDNs, individually or collectively, are equally sanctioned. All assets of these SDNs under U.S. jurisdiction are frozen and U.S. individuals and entities are prohibited from doing business with these institutions unless authorized by OFAC. Non-U.S. persons may also be sanctioned themselves if they materially assist, sponsor, or provided financial, material, or technological support for, or goods or services to, such Russian SDN financial institutions.

There are several general licenses issued in connection with these designations, including General License 2, 3, 5, 6, 7, 8, 9, 10, 11, and 12.³ Most notably, Russia-related General License 11 authorizes certain activities related to the wind-down of transactions involving Otkritie, Sovcombank, VTB Bank, and all entities in which the abovementioned own a 50 percent or greater interest. Such wind-down must be completed by March 26, 2022. Similarly, Russia-related General License 3 also authorizes a wind-down of transactions with respect to VEB, as well as VEB’s servicing of sovereign debt, which must be completed by March 24, 2022. Note that there are no general licenses authorizing a wind-down of transactions with respect to PSB.

In addition, OFAC issued Directive 2 under E.O. 14024 to impose correspondent and payable-through account sanctions on Sberbank, which, according to the U.S. Government, holds about a third of all bank assets in Russia and is majority-owned by the Government of Russia. Directive 2 takes effect on March 26, 2022 and prohibits U.S. financial institutions from: (i) opening or maintaining a correspondent account or payable-through account for or

² In addition to the listed entities, 12 Otkritie subsidiaries, 22 Sovcombank subsidiaries, 42 combined VEB and PSB subsidiaries, and 5 vessels associated with a subsidiary of PSB were also designated as SDNs.

³ These general licenses authorize certain transactions related to: (1) international organizations and entities, (2) agricultural and medical commodities and the COVID-19 pandemic, (3) overflight and emergency landings, (4) energy, (5) dealings in certain debt or equity, (6) derivative contracts, (7) the wind-down of transactions involving certain blocked persons, and (8) the rejection of certain transactions involving Otkritie, Sovcombank, and VTB Bank.

on behalf of a designated entity; and (ii) processing transactions involving any such entities. All U.S. financial institutions must reject payments Sberbank (or any other Directive 2 entity) attempts to process in U.S. dollars unless exempt or otherwise authorized by OFAC. Currently, Directive 2 only applies to Sberbank and its subsidiaries.

Restrictions on Dealings in Sovereign Debt or Debt of Equity in State-Owned (and Some Privately Owned) Entities

Pursuant to E.O. 14024, OFAC released Russia-related Directive 1A, which expands existing U.S. restrictions on dealings by U.S. financial institutions in Russian sovereign debt to prohibit U.S. financial institutions from participating in the secondary market for ruble or non-ruble denominated bonds issued by the Russian Central Bank, Ministry of Finance or the National Wealth Fund. Specifically, Directive 1A prohibits:

- Participation in the primary market for ruble or non-ruble denominated bonds issued after June 14, 2021 by the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the Russian Federation;
- Lending ruble or non-ruble denominated funds to the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the Russian Federation; and
- Participation in the secondary market for ruble or non-ruble denominated bonds issued after March 1, 2022 by the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the Russian Federation.

Pursuant to sections 1(a), 1(d) and 8 of E.O. 14024, OFAC issued Russia-related Directive 3, which prohibits U.S. persons or persons within the U.S. from engaging in all transactions in, provision of financing for, and other dealings in new debt of longer than 14 days maturity or new equity of 11 state-owned and 2 privately owned enterprises where such new debt or new equity is issued on or after March 26, 2022. The impacted enterprises include Alfa-Bank, Alrosa, Credit Bank of Moscow, Gazprom, Gazprombank, Gazprom Neft, Rushydro, Russian Agricultural Bank, Russian Railways, Rostelecom, Sberbank of Russia, Sovcomflot, and Transneft. With respect to any additional entities designated in the future under Directive 3, the prohibitions with respect to new debt or new equity of such entities will become effective 30 days after such determination.

Blocking Sanctions Related to the Nord Stream 2 Pipeline

Pursuant to the Protecting Europe's Energy Security Act and E.O. 14039, OFAC issued blocking sanctions against Nord Stream 2 AG (a Swiss firm whose parent company is the Russian state-owned Gazprom) and its Chief Executive Officer, Matthias Warnig. OFAC also issued Russia-related General License 4, which authorizes a limited "wind-down" of transactions with these designated persons before March 2, 2022.

Sanctions Against Russian and Belarusian Elites

OFAC designated several individuals identified as Russian and Belarusian elites close to Putin, including Putin himself, the Russian Minister of Foreign Affairs, Chief of the General Staff of the Armed Forces of the Russian Federation, and the Minister of Defence of the Russian Federation. OFAC also designated as SDNs several Belarusian defense officials and individuals within Belarusian President Lukashenka's inner circle. These designations require all property and interests in property of these individuals that are in the U.S. or in the possession or control of U.S. persons be blocked and reported to OFAC. In addition, any entities that are owned directly or indirectly, 50 percent or more by one or more blocked persons are also blocked. Non-U.S. persons may be sanctioned themselves if they materially assist, sponsor, or provide financial, material, or technological support for, or goods or services to, such SDNs.

Sanctions Against Belarus's Defense Sector and Financial Institutions

Using E.O. 14038, which was issued in relation to the fraudulent 2020 Belarusian presidential election and its aftermath, OFAC designated two Belarusian state-owned banks and several state-owned and private-owned defense and security related entities as SDNs for their support of Russia's invasion of Ukraine.

U.S. Export Controls

In conjunction with OFAC's actions discussed above, BIS imposed significant new restrictions on the export of many commodities, software, and technology to Russia and Russian end users as well as to Covered Regions of Ukraine.⁴ The new export control restrictions concerning Russia are focused on targeting the Russian defense, aerospace and maritime sectors and preventing Russia from accessing items needed for military activities, including sophisticated technologies designed or produced in the U.S. or certain foreign made items that contain or are based on certain U.S.-origin technology. The new export controls apply to a wider range of items "subject to the EAR" as well as to certain foreign made items, derived from certain U.S. technology. The developments in U.S. export controls are, therefore, relevant to both U.S. and non-U.S. firms.

Key new export control restrictions include:

- *A Wider Range of U.S. Controlled Items Now Require a License for Export to Russia:* Any items subject to the EAR and included on the Commerce Control List ("CCL") in Categories 3 (Electronics), 4 (Computers), 5 (Telecommunications & Information Security), 6 (Sensors & Lasers), 7 (Navigation and Avionics), 8 (Marine), or 9 (Aerospace & Propulsion) require licenses.⁵ This change results in numerous types of items that previously did not require a license for export, re-export to Russia or transfer (in-country within Russia) now requiring a license from the U.S. Government in order to export, re-export, to Russia or

⁴ Consistent with E.O. 13685 and E.O. 14065, the term "Covered Regions of Ukraine" in the BID Final Rule includes the land territory in the DNR and LNR regions, as well as any maritime areas over which sovereignty, sovereign rights, or jurisdiction is claimed based on occupation of (Crimea), or purported sovereignty (DNR and LNR) over, those land territories.

⁵ "Subject to the EAR" is a term used to describe those items over which BIS exercises jurisdiction under the EAR. In broad terms, all items in the U.S., all U.S.-origin items, and certain foreign-made commodities that incorporate, are bundled with, or are the direct product of controlled U.S.-origin commodities are considered "subject to the EAR." 15 C.F.R. § 734.3.

transfer such items within Russia. BIS will review the vast majority of license applications to Russia for these ECCNs under a policy of denial, meaning that exports of such products subject to the EAR are unlikely to be approved for export to Russia.

- *A License is Now Required for Exports and Re-Exports to the Covered Regions of Ukraine:* A license is now required for the export and re-export to the Covered Regions of Ukraine and the transfer within the Covered Regions of Ukraine, of all items subject to the EAR, other than food and medicine classified as EAR99 and certain software for Internet-based personal communications. As with the new license restrictions related to Russia, the vast majority of license applications related to the Covered Regions will be reviewed under a policy of denial.
- *A Limitation on License Exceptions for Exports to Russia:* Only certain license exceptions, with narrowly tailored parameters, remain viable for exports to Russia: (1) TMP (Temporary Imports, Exports, Re-exports, and Transfers In-Country), for items for use by the news media, (2) GOV, for certain government activities, (3) TSU (Technology and Software Unrestricted), for software updates to civil end users that are subsidiaries of, or joint ventures with, companies headquartered in the United States or partner countries, (4) BAG (Baggage), for baggage, excluding firearms and ammunition, (5) AVS (Aircraft, Vessels, and Spacecraft), for aircraft flying into and out of Russia, (6) ENC (Encryption Commodities, Software, and Technology), for encryption items, but not if they are destined for Russian government end users and Russian state-owned enterprises, and (7) CCD (Consumer Communication Devices), for consumer communication devices, but not if they are destined for government end users or certain individuals associated with the government.
- *An Expansion of Restrictions on Russian Military End Users and Military End Uses:* Under the expanded § 744.21 of the EAR, the only items that can be exported to Russia for a military end use or user without a license are food and medicine classified as EAR99 and certain information security items/software classified as ECCN 5A992.c or 5D992.c.
- *New Foreign Direct Product Rule:* The Final Rule also included an expansion of the Foreign Direct Product (“FDP”) Rule to create two new rules: (1) the Russia FDP Rule and (2) the Russian Military End User (“MEU”) FDP Rule.
 - The two new FDP rules allow BIS to establish jurisdiction over certain foreign-produced items that are made outside of the United States using certain U.S.-origin software or technology. As a result, a license from BIS may be required to export certain foreign-produced items to Russia even if those items were not manufactured in the U.S. and would not otherwise be subject to the EAR. Note that the two FDP Rules do not apply to Russia-related exports from certain “partner countries” that are adopting or have expressed intent to adopt substantially similar export restrictions.⁶

⁶ Exports, re-exports, and transfers (in-country) from the following countries are not subject to these rules: Australia, Austria, Belgium, Bulgaria, Canada, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, New Zealand, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

- The Russia FDP Rule provides that foreign-produced items are subject to the EAR if the item is (1) not EAR99 and is the direct product of certain U.S. technology or software⁷ or is the direct product of a plant or major plant component that is itself the direct product of the specified technology or software and (2) there is knowledge that the item is destined for Russia or will be incorporated in or used in the production of certain items produced in or destined for Russia.
 - Any item which is subject to the EAR, by virtue of the Russia FDP Rule, would require a license from the U.S. Government in order to be exported, re-exported, or transferred, even to a transit country.
- The Russia-MEU FDP Rule is more extensive and applies to items produced outside of the U.S., where the foreign produced item is (1) the direct product of *any* technology or software which is included on the CCL or the direct product of a plant or major plant component that itself is the direct product of such technology or software and (2) there is knowledge that the item (a) will be incorporated into or used in the production or development of any item produced, purchased, or ordered by an entity which has received a special “footnote 3” designation (*i.e.*, a Russian MEU) on the Entity List maintained by BIS or (b) where any such person is a party to a transaction involving the item.
 - Note that the Russian MEU FDP Rule is implicated where the underlying U.S. technology or software is on the CCL.
- *Additions to the Entity List*: BIS transferred 45 Russian entities from the existing Military End User (“MEU”) List to the Entity List, added 2 new Russian entities, and revised 2 existing Russian entries on the Entity List. The Russia-MEU FDP Rule footnote 3 designation will apply to all 49 of these entities and a license will be required to transfer most items subject to the EAR (including foreign produced items subject to the Russia-MEU FDP Rule) to these entities.

⁷ This includes any ECCN in product groups D or E in Categories 3-9 of the CCL.

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