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U.S. and Allies Impose "First Tranche" of New Economic Sanctions in Response to Russian Action in Ukraine

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For months now, the West has watched a steady flow of satellite images showing Russian conventional forces and equipment being deployed in extraordinary numbers surrounding Ukraine. Western leaders have made the trek to Russian President Vladimir Putin's table in a multipronged diplomatic effort to avert war, with the United States and its closest allies all promising to levy harsh sanctions on Russia if it invades Ukraine.

On February 22, 2022, following the Russian Federation's purported recognition of the so-called Donetsk People's Republic (DNR) and Luhansk People's Republic (LNR) regions of Ukraine, and reports of Russian forces in those regions, the United States announced its "first tranche" of sanctions against Russia. The United Kingdom, Germany, the European Union, and other countries also announced sanctions in response to Russia's actions.

This advisory addresses the existing U.S. sanctions landscape regarding Russia, the new U.S. sanctions announced in this initial round, and the similar packages announced by key U.S. allies. Russian forces began launching extensive attacks on Ukraine on February 24, 2022. In response, the U.S. and its allies are signaling that follow-on partial or comprehensive sanctions and additional export controls will be announced as discussed more fully below. Companies with a direct or indirect nexus to Russia or Ukraine are encouraged to monitor developments in this space and identify any exposure to the Russian financial system, as well as energy and high-technology industries, in advance of forthcoming restrictive measures.

Overview of Existing U.S. Sanctions on Russia

Sanctions have been a central and consistent element of U.S. foreign policy to counter Russian influence over the past several years. Since 2014, the United States has administered an economic sanctions program in response to Russia's annexation of Crimea. The United States has also implemented additional sanctions aimed at countering Russia's cyber-hacking and interference in U.S. elections. These sanctions programs are generally based on certain national emergency authorities that are granted to the President in the National Emergencies Act and the International Emergency Economic Powers Act. The Obama, Trump, and now Biden

Administrations have used these authorities, as well as a variety of Executive Orders, and other legislation to establish sanctions targeting sectors of the Russian economy and specific Russian entities and persons.

When Russia annexed the Crimean Peninsula in 2014, President Obama issued a series of Executive Orders authorizing the designation of various Russian entities and persons as Specially Designated Nationals (SDNs), prohibiting U.S. persons from engaging in transactions with them (Executive Orders 13660, 13661, 13662, 13685) and blocking their property to the extent that it comes under control of U.S. persons. Executive Order 13685 prohibited the export and import of goods, technology, or services to and from Crimea and new investments in Crimea, an embargo that remains in place today.

Congress also responded by passing: (1) the Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act of 2014; (2) the Ukraine Freedom Support Act of 2014; (3) the Countering Russian Influence in Europe and Eurasia Act of 2017, as amended by the Countering America's Adversaries Through Sanctions Act; and (4) Protecting Europe's Energy Security Act of 2019 (PEESA), legislation that authorized Presidents Obama and Trump to levy sanctions on Russia. Additionally, in April 2021, President Biden issued Executive Order 14024 authorizing the blocking of property of certain persons based on the "harmful foreign activities of the government of the Russian Federation." Included in several of these laws and Executive Orders is the authorization for the use of secondary sanctions on non-U.S. persons and entities that are generally found to provide material assistance or facilitate significant transactions with sanctioned entities or engage in other specifically sanctionable activities.

The current sanctions regime against Russia consists of hundreds of Russian entities and persons designated as SDNs, as well as a "sectoral" sanctions program on specific sectors of the Russian economy, including the financial, defense, and energy sectors, with specific prohibitions on U.S. persons engaging in certain transactions with designated entities and persons.

In addition to these sanctions programs, there are extensive export controls administered by the U.S. Department of Commerce's Bureau of Industry and Security (BIS). Since 2014, BIS has placed dozens of Russian entities on the Export Administration Regulations (EAR) Entity List, imposing a license requirement to export, reexport, or transfer items that are subject to the EAR. BIS also administers certain Russian industry sector sanctions that impose a license requirement on the export of certain items that are intended for use in the production or exploration of gas or oil in Russian deep-water and arctic offshore locations or shale formations. In 2020, BIS also expanded its Military End Use and End User Rules involving entities and activities in the Russian Federation.

Recent Congressional Efforts on Russia Sanctions

Despite the broad and seemingly more-than-sufficient existing authority for President Biden to impose sanctions against Russia, Congress has recently taken a renewed interest in sanctions legislation in response to Putin's actions. These legislative efforts highlight certain domestic U.S. political dynamics and provide some insight into the types of punitive measures that are being considered by the U.S. government.

Senator Ted Cruz (R-TX) used a Senate procedural mechanism to prevent the Senate confirmation of about three dozen ambassadors and senior State Department nominees for the Biden Administration. Ultimately, Cruz reached a deal to release his hold on these nominees in exchange for a January vote on his bill to sanction the Nord Stream 2 pipeline project, which was built to transport Russian natural gas to Germany and the rest of the EU. Cruz's bill, S. 3436, would have required the President to impose sanctions on any company "responsible for the planning, construction, or operation of the Nord Stream 2 pipeline or a successor entity." Because such sanctions would directly affect Germany and other U.S. allies and Western companies, at the time, the Administration opposed the bill, preferring instead to maintain the flexibility to work closely with these allies on the breadth and timing of any such step.

Subsequently, Senator Bob Menendez (D-NJ) introduced S. 3488, the Defending Ukraine Sovereignty Act of 2022, with a companion bill (H.R. 6470) introduced in the House of Representatives. The Act, if passed, would have provided President Biden with a host of specific sanctions measures to impose on key segments of the Russian economy, with a particular focus on its banking sector. Negotiations between Democrats and Republicans in the Senate hit a stalemate in February with key outstanding issues including the timing of the imposition of the sanctions, the extent of secondary sanctions, and Nord Stream 2 sanctions, among others. Ultimately, the Senate passed a symbolic resolution expressing U.S. support for Ukraine, denouncing the Russian military buildup, and encouraging President Biden, in the event of further invasion of Ukraine, to "impose significant costs on the Russian Federation to restore peace in Europe."

Meanwhile, President Biden has exercised the flexibility he has to continue coordination with European allies.

The United States Has Imposed a First Tranche of New Sanctions Against Russia

In response to Russia's recognition of the independence of the DNR and LNR, President Biden signed the Executive Order on Blocking Property of Certain Persons and Prohibiting Certain Transactions with Respect to Continued Russian Efforts to Undermine the Sovereignty and Territorial Integrity of Ukraine, which effectively blocks the majority of investment, trade, and financing by U.S. persons in the two areas. The EO prohibits: (1) new investment in the two separatist areas by U.S. persons; (2) direct and indirect imports from either area into the United States; (3) exports and reexports to either area from the United States or by U.S. persons, wherever located; and (4) financing by U.S. persons to foreign persons for transactions that would be barred if completed by a U.S. person or within the United States.

While the EO blocks a majority of transactions involving U.S. persons, the Office of Foreign Assets Control (OFAC) issued six general licenses that allow U.S. persons to conduct certain transactions within the DNR and LNR under strict guidelines, including transactions related to the short-term wind down of business activities in the two areas and transactions involving agricultural commodities, medicine, and medical devices, as well as medical supplies relating to the COVID-19 pandemic. The EO also allows for sanctions to be imposed on various persons connected with the DNR and LNR, including leaders of the separatist governments, businesses, and persons who have materially supported those who are subject to sanctions under the EO.

OFAC also issued a directive under Executive Order 14024 prohibiting transactions by U.S. financial institutions involving Russian sovereign debt relating to the Central Bank of the Russian Federation, National Wealth Fund of the Russian Federation, or Ministry of Finance of the Russian Federation. These restrictions seek to cut off a core method the Russian government relies on for financing from the West. The ban includes participation on the primary and secondary markets for Russian government bonds issued by the three state entities, as well as loans, superseding a prior directive that only banned similar activities in the primary market and loans. The prohibition on activities in the secondary market takes effect for bonds issued after March 1, 2022.

The U.S. also imposed sanctions on various Russian entities. First, sanctions were placed on two Russian state-backed financial institutions: The Corporation Bank for Development and Foreign Economic Affairs Vnesheconombank (VEB) and Promsvyazbank Public Joint Stock Company, as well as 42 of their subsidiaries. Both institutions are important to the Russian defense industry and to the Russian economy in general. OFAC issued two general licenses that allow for transactions involving VEB in the servicing of Russian government bonds issued before March 1, 2022, as well as transactions necessary for winding down business involving the bank, which must be completed no later than 12:01 eastern daylight time, March 24, 2022. Sanctions also targeted individuals within Putin's inner circle and their family members, including two former Russian prime ministers and their sons.

Lastly, on February 23, 2022, the White House announced it would move ahead with sanctions on Nord Stream 2 with OFAC adding both Nord Stream 2 AG—a Swiss firm whose parent company is Gazprom—and its CEO to the SDN list, using existing designation authority granted under PEESA.

Multiple U.S. Allies Have Also Announced Their First Tranches of New Sanctions Against Russia

As tensions have escalated around Ukraine, the Biden Administration has made it clear that the United States has been coordinating with allies to implement a multilateral approach to sanctions and penalties against Russia. That coordinated effort appeared to bear fruit this week, led by the United Kingdom and Germany, with further support from Canada, the EU, Japan, Taiwan, and Singapore.

The United Kingdom took action against Russia on February 22, 2022 by announcing the imposition of sanctions against five Russian banks: Rossiya, IS Bank, General Bank, Promsvyazbank, and the Black Sea Bank. The United Kingdom has indicated that it is freezing the assets of the five banks due to their involvement in providing financial support for the Kremlin's efforts to invade Ukraine. Although not the largest or most prominent banks in Russia, the imposition of sanctions against these banks is a clear warning that the United Kingdom is willing to target Russian financial institutions and restrict their access to the world banking system should Russia continue its efforts in Ukraine.

The United Kingdom also announced its imposition of sanctions against three Russian oligarchs with close ties to President Putin: Gennady Timchenko and Boris and Igor Rotenberg. The United Kingdom has frozen the assets of these individuals and imposed a travel ban as well. This step brings the United Kingdom in line with the U.S. position on these individuals, whom the United States previously designated as SDNs.

In a strongly worded announcement of the sanctions, the United Kingdom indicated its intention to impose additional measures in line with U.S. sanctions, including the imposition of comprehensive sanctions prohibiting UK persons from engaging in business in the DNR and LNR regions and prohibiting the issuance of Russian sovereign debt on the UK markets. According to the United Kingdom's announcement, if Russian aggression in Ukraine continues, the United Kingdom intends to utilize sanctions focused on "isolating Russia from the global economy, and making it far more difficult for oligarchs and businesses to operate outside their own borders."

In addition, Germany highlighted the ability of countries to utilize tools other than traditional sanctions to penalize Russia for its actions. Following significant international speculation in recent weeks, German Chancellor Olaf Scholz announced that Germany was halting the approval process for the multibillion-dollar Nord Stream 2 pipeline. This step has the potential to cause substantial long-term economic harm to Russia, which had intended to utilize the pipeline to distribute natural gas to Germany and elsewhere in the EU. The move was all the more significant because it has the potential to negatively impact Germany by denying the country access to lower-priced natural gas in the future.

Canada and the EU have likewise indicated that they are pursuing sanctions against Russia that appear to generally align with U.S. sanctions efforts, including targeting Russian banks, targeting Russian access to foreign capital and financial markets, and restricting trade with the DNR and LNR regions. Japan, Taiwan, and Singapore also indicated their intention to take steps to limit technology exports to Russia.

Potential Future Tranches

The sanctions announced thus far are only the first tranche, with additional sanctions packages reportedly to be imposed now that Russia has invaded Ukraine. As highlighted by the prior legislative efforts, as well as other prior sanctions programs, portions of which could be used as models to address the situation in Ukraine, potential future sanctions targets may include:

- Any entity or corporate officer involved in the planning, construction, or operation of the Nord Stream 2 pipeline, subject to coordination with U.S. allies (as noted above, in the aftermath of Germany's announced suspension of the pipeline's approval, the White House announced sanctions against the operator of the controversial pipeline).

- Additional Russian financial institutions, such as Sberbank, VTB, Gazprombank, the Russian Direct Investment Fund, Credit Bank of Moscow, Alfa-Bank, Rosselkhozbank, FC Bank Otkritie, Sovcombank, Transkapitalbank.

- Certain entities in targeted Russian industries, including oil and gas extraction and production; coal extraction, mining, and production; minerals extraction and processing; defense; and any other sector the President determines the imposition of sanctions is in the United States' national security interest.

- Russian President Vladimir Putin, as well as the prime minister, foreign minister, defense minister, chief of the general staff of the armed forces, and commanders of various branches of the armed forces, and, potentially, close family members.

- Providers of specialized financial messaging services to banks (e.g., SWIFT), with the possible trigger being continuing the provision of services to newly sanctioned Russian financial institutions, and likely following diplomatic coordination with U.S. allies.

- Agencies, entities, or instrumentalities owned or operated by the Russian government, which would follow a Venezuela-style sanctions model and represent a substantial expansion of any sanctions previously used against Russia.

U.S. sanctions could also be accompanied by additional U.S. export controls toward Russia. One possibility is extension of the EAR Foreign Direct Product Rule. This rule would impose U.S. export controls on certain foreign-produced items that are the direct product of certain U.S.-origin technology or software if there is knowledge that the foreign-produced item will be incorporated into or used in the production or development of any part, component, or equipment produced, purchased, or ordered by a designated entity, or that such entity is a party to any transaction involving such product. The rule was previously expanded in 2020 to curtail Huawei's access to components made with certain technology or software that was subject to the EAR.

Applying the rule to foreign-made products destined to certain Russian entities would make it difficult for Russian businesses and industries that rely on U.S.-origin technology. The White House signaled in late January that it is focusing on "downstream products that are critical to its own ambitions to develop high-tech capabilities in aerospace and defense, lasers and sensors, maritime, AI, robotics, quantum, et cetera."

It is also likely that additional Russian entities will be named to the EAR Entity List and the Military End User List, limiting their ability to receive commodities, technology, or software that are subject to the EAR.

Conclusion

The initial round of sanctions announced so far this week remain somewhat tailored. The Russian government has been further cut off from Western debt markets. Selected banks have been sanctioned. While one of them, VEB, is an active economic development bank that supports many Russian companies, some of which are now also sanctioned because of VEB's interests, the banking sanctions announced are not far reaching enough to make it especially difficult for companies to pay or be paid by Russian counterparties in ordinary course cross-border commercial dealings. In contrast, were the United States to sanction the 12 largest financial institutions, as suggested in S. 3488, we expect significant difficulties in completing transactions with Russian counterparties.

Thus far, the additional sanctions designations and potential export control designations under the EAR remain the types of measures that most companies' existing compliance and transaction screening systems should be able to manage without major changes.

Additional export controls could also have a severe impact on Russian industries and the overall economy by blocking access to U.S.-origin and certain foreign-made technology. For example, Huawei's inclusion under the expanded Foreign Direct Product Rule is believed to have contributed to the Chinese firm's first annual revenue decrease in 2021 of 28.9 percent over revenue from the previous year. The expansion of this rule to Russia would give rise to significant additional compliance obligations for foreign manufacturers selling products to Russia.

The situation on the ground in Ukraine continues to evolve as does the Western response. Companies with interests in the region will need to continually assess the impact of these developments on their business and operations.

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