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February 5, 2024.

Sanctions and their application — overview of the main developments in 2023 and likely trends in 2024

The year 2023 was marked by an intensification of sanctions pressure against Russia. According to some estimates, the number of personal sanctions imposed on Russian companies and individuals ("blocking sanctions") alone is now approaching 20,000. Many countries have also started to develop legal mechanisms aimed at countering the sanctions circumvention .

It is not easy to navigate such a large-scale and multifaceted sanctions regime and keep up with the details of how the sanctions are applied in practice.

In this review, we present what we consider to be the key developments in the area of sanctions and their application in 2023, in the United States, the European Union and the United Kingdom, as well as likely trends in this area in 2024, which should be taken into account when doing business.

MAIN DEVELOPMENTS IN SANCTIONS AND THEIR APPLICATION IN 2023

US

1. Possibility of imposing blocking sanctions on financial institutions in third countries

#blocking sanctions
#regulation and compliance

In December 2023, the U.S. President signed Executive Order 14114 which sets out the grounds for blocking sanctions against foreign financial institutions that have:

1. conducted or facilitated a "significant" transaction or transactions for or on behalf of any person sanctioned for activities in certain sectors of the Russian economy (technology, defense and related materiel, construction, aerospace, manufacturing, and other sectors that may be determined by the Secretary of the Treasury, in consultation with the Secretary of State, to support the military-industrial base of the Russian Federation);

2. conducted or facilitated a "significant" transaction or provided services in relation to the military-industrial base of the Russian Federation, including the sale, supply or transfer of any item or class of item specified in a separate list.

The same actions performed by foreign financial institutions may be grounds for restrictions on opening or maintaining correspondent or transit accounts for these institutions.

Why it is important

Although the above guidance and the _state that the purpose of the new rules is to restrict the military-industrial sector of the Russian Federation, they primarily make it more difficult (a) for all Russian companies to settle accounts and (b) for them or their subsidiaries to pass compliance controls in banks around the world.

Financial organizations settling accounts in dollars are required to introduce even stricter verification procedures in relation to counterparties from Russia or with Russian participation. As a result banks are refusing to open bank accounts, or at least making this process more difficult, and refusing to conduct banking operations. We are already seeing examples of consequences of this E.O. - for example, Turkish banks began closing the accounts of Russian companies earlier this year, fearing SDN listing.

2. Inclusion of companies from jurisdictions "friendly" to Russia on the SDN list

#blocking sanctions

Over the course of 2023, a consistent trend has emerged in U.S. designation of companies and individuals: not only Russian companies and individuals, but also individuals from jurisdictions that the OFAC believes are frequently used to circumvent US sanctions, namely Turkey, the UAE, China, Kyrgyzstan, Tajikistan and Cyprus are being added to the list. In addition to persons supplying the Russian military-industrial sector, companies from these countries that supply electronics, computer and aviation components, or provide financial and logistical services to Russian companies have been designated.

Why it is important

For companies and individuals from jurisdictions "friendly" to Russia, the risk of being included on the SDN list increases significantly when dealing with Russian entities engaged in the electronics, aviation, financial and logistics services sectors.

3. Examples of removal from the SDN list after filing a lawsuit challenging sanctions

#blocking sanctions
#delisting

In the summer and fall of 2023, OFAC announced the delisting of several former managers of Otkritie Bank from the SDN list. These are the first examples of the delisting of individuals sanctioned under Executive Order 14024.

The basis for the imposition of blocking sanctions on the former managers was their alleged connection with Otkritie Bank, which had previously been sanctioned. This was despite the fact that some of the managers (E. Titova and A. Golikov) were no longer employees of Otkritie Bank when the US sanctions were imposed on them.

They applied to the OFAC to be removed from the sanctions list shortly after being listed. OFAC reviewed their applications for a year, requesting additional information, but failed to make a decision. Without waiting for a decision from OFAC, managers therefore petitioned the US District Court for the District of Columbia to challenge the decision to include them on the SDN list. One month after this, the OFAC removed them from the SDN list pending a court hearing.

Why it is important

OFAC is one of the busiest sanctions regulators in the world and the timeline for obtaining decisions from it could be long and unpredictable. The above cases reveal an important procedural aspect of SDN delisting, namely the possibility of expediting OFAC's decision by bringing a case in a US federal court.

4. "Red flags" that may indicate the circumvention of sanctions and export restrictions

#regulation and compliance

In March 2023, the US Department of Commerce's Bureau of Industry and Security ("BIS"), the US Department of Justice, and the OFAC issued a joint compliance note on the practice of circumventing sanctions and export restrictions via third party intermediaries.

This compliance note lists common "red flags" that may indicate the circumvention of sanctions and export restrictions, and gives several examples of prosecution for such circumvention. For example, concealing of information about the end user of a service or product, use of third-party companies for payment, or use of supply routes including Armenia, Turkey, and Uzbekistan to deliver goods are all considered suspicious.

Why it is important

The compliance note clarifies exactly what circumstances OFAC and BIS consider to be an indication of the use of a "third party intermediary" to circumvent sanctions when supplying goods or services. The use of similar mechanisms to those mentioned in the compliance note, even without the intention of evading sanctions, may make it more difficult for foreign entities to agree to a transaction or make payments for services and goods without being in breach of the US sanctions.

European Union

1. New criterion for the imposition of blocking sanctions by the EU

#blocking sanctions
#regulation & compliance

12th package of EU sanctions introduced a a new ground for imposing blocking sanctions (amendments to Article 3 of Regulation No. 269/2014).

Blocking sanctions can now be imposed on:

- Russian legal entities previously owned or controlled by EU-registered companies, if the ownership or control of such Russian legal entities has been compulsorily transferred by the Government of the Russian Federation through laws, regulations, other legislative instruments or other action of a Russian public authority,
- individuals and legal entities, organizations and bodies that have benefited from such transfers,
- individuals who have been appointed to the governing bodies of such companies without the consent of the EU entities which previously owned or controlled them.

These changes are seen as a response to Decree of the President of the Russian Federation No. 302 "On the Temporary Management of Certain Property", dated 25.04.2023, which provides for the temporary management of movable and immovable property of foreign persons related to "unfriendly" foreign states, and of securities, shares in the authorized (share) capital of Russian legal entities and property rights owned by individuals and entities from "unfriendly" foreign states, if such assets are located in the territory of the Russian Federation. In accordance with this Decree, among others, Unipro, Fortum, Danone Russia, Baltika Breweries, and Rolf were all placed under the temporary management of the Federal Agency for State Property Management.

Why it is important

This new ground increases the risk of blocking sanctions not only for the companies placed under temporary management, but also for their new managers and those who benefited from their temporary management, for example, by receiving interest on any financing provided to them.

2. Possibility of confiscation of frozen assets in the EU

#asset confiscation
#regulation & compliance

One key element introduced in the 12th package of EU sanctions was the appearance of legal grounds for the confiscation of assets.

Regulation No. 269/2014 introduced Article 5a, which empowers the competent authorities of EU Member States to authorize the release of frozen assets, or transactions therewith, following a decision by a judicial or administrative authority of an EU Member State, to deprive, in the public interest, an individual or legal entity on the sanctions list of assets that they own or control. The Article provides for the payment of compensation to such persons. However, they will not actually be able to receive such compensation, as it will remain frozen due to sanctions restrictions.

Why it is important

The confiscation of frozen assets of designated Russian individuals or entities was the subject of much political discussion in 2023. Following the issue of the above Regulation it is possible that the property of Russian individuals under sanctions may be confiscated, rather than merely frozen.

3. A successful example of challenging the "leading businessperson" criterion

#delisting

In December 2023, Sergei Mndoyants successfully challenged his designation before the General Court of the EU. These sanctions were imposed in April 2022, on the grounds that he is (1) a former vice president of AFK Sistema, (2) a former vice president of and shareholder in VLM-Invest, and (3) a board member of the Council for Foreign and Defense Policy, which advises the Russian Government. These circumstances, according to the EU Council, confirmed that he was a "leading businessperson" in sectors of the economy that generate substantial revenue for the Russian government (in accordance with Article (g)(1)2 of EU Council Decision 2014/145).

The applicant successfully challenged the finding that he was a leading businessperson. He pointed out that he had left his position at AFK Sistema in 2012, that VLM-Invest is a small private company providing consulting services, and that he is not an active participant in the work of the Council for Foreign and

Defense Policy, which is a non-profit, non-governmental and independent organization with a large number of participants. He stressed that he does not control any of these organizations.

The Court concluded that the EU Council had failed to demonstrate that the applicant was a leading businessman involved in key sectors of the Russian economy, and canceled the decision to place him on the sanctions list.

Why it is important

This case is an example of a successful challenge to the "leading businessperson" criterion, which is a vague "umbrella" term that covers a very wide range of individuals. Such decisions increase the chances that those who do not hold significant positions or own large businesses will be excluded from the list of sanctioned persons.

UK

1. The question of "ownership and control" test in the Russia sanctions regulations

#regulation and compliance

In October 2023, the Court of Appeal of England and Wales issued its judgment in *Boris Mints & Ors v PJSC National Bank Trust & Anor.*

This case has attracted much attention due to its interpretation of the "control" test, i.e. whether or not an entity that is not itself designated is controlled by persons that are designated (Regulation 7 of the UK's Russia Sanctions Regulations). In this case, the Court of Appeal considered whether Trust Bank, which is not under UK sanctions, could be deemed to be controlled by designated persons, namely Russian President V.V. Putin and Head of the Central Bank of the Russian Federation, E.S. Nabiullina, given that the Central Bank of the Russian Federation owns 99.9% of Trust Bank's shares.

In considering the parties' arguments, the court found that the "control" test is formulated broadly enough to conclude that the President of the Russian Federation has the ability to manage and make decisions with respect to any company in the Russian Federation. Consequently, in the sense of Regulation 7 , any Russian company could potentially be recognized as a sanctioned company.

Because the court's findings potentially extended the restrictions to every Russian company, the publication of the decision was followed by a clarification in the form of a statement issued by the UK Foreign Office, which makes it clear that there is no presumption on the part of the Government that a private entity based in or incorporated in a jurisdiction is necessarily controlled by the public officials of that jurisdiction. Similar conclusions were also reflected in the official explanation from Her Majesty's Treasury's Office of Financial Sanctions Implementation ("OFSI") on the issue of ownership and control.

The High Court of England and Wales further addressed the issue of the control criterion in its decision in Litasco SA v Der Mond Oil and Gas Africa SA & Anor. The High Court ruled that in order to conclude that an entity is controlled by a sanctioned person (including an official), evidence of an "existing influence" by such person over the affairs of the entity is required, and the mere fact, or presumption, that the sanctioned person is "in a position" to intervene in the affairs of the company is not sufficient.

Why it is important

The “ownership and contro;” test is the basic test to determine whether or not an entity is affected by sanctions and thus what will happen to its assets. The inconsistent interpretation of abovementioned regulation has led to ambiguity in the relevant court practice, which creates problems for all those affected by the UK sanctions regime. Judicial decisions and guidance issued following the Mints case have demonstrated a tendency towards a narrower interpretation of this test.

2. New reporting requirements for individuals under UK sanctions

#regulation and compliance

At the end of 2023, the UK's Russia Sanctions Regulations were supplemented by Regulation 70A, requiring all sanctioned persons (referred to as “designated persons”) to file a report of their assets with the OFSI.

The regulation provides for two types of reports:

- for UK designated persons (i.e. UK citizens, or an entity incorporated or constituted under the law of any part of the UK), the report must disclose the funds and economic resources that they own, control or hold in any jurisdiction.
- for non-UK designated persons, the report must disclose the assets that they own, control or hold in the UK.

Any funds or economic resources with a value exceeding £10,000 must be reported. If multiple funds or economic resources of the same type (e.g. items of jewelry, works of art, or bank accounts) have a total value exceeding £10,000, they should also be reported.

Persons who were subject to sanctions as of 12/26/2023 must file such report with the OFSI by 05/03/2024 (10 weeks from the date the requirement arose). Those who are placed on the sanctions list at a later date must file such report within 10 weeks of the date the sanctions were imposed.

A failure to comply with these requirements, and the provision of false information, is a criminal offense, and a civil monetary penalty may be imposed.

Why it is important

This is the first time that designated persons have been required to disclose their own assets. In the absence of further clarification, it is not yet clear whether the duty to disclose assets also relates to assets that are indirectly held or indirectly controlled. However, the duty could potentially affect a very wide range of persons with assets in the UK.

3. Restrictions on the processing of correspondent banking payments by UK banks

#regulation and compliance

In December 2023, Regulation 17A of the UK's Russia Sanctions Regulations was amended. The restrictions on correspondent banking relationships now cover payments in any currency, not just sterling. The regulation prohibits British financial institutions from processing correspondent payments made via sanctioned banks, even if the recipient and sender of the payment are not under sanctions.

Some general licenses (e.g. INT/2023/3024200) provide exceptions to the application of regulation 17A.

In addition, a separate restriction, a ban on correspondent banking relationships, was imposed on certain Russian banks from December 2023. The ban on correspondent banking relationships is currently in effect for 26 Russian banks.

Why it is important

These restrictions create additional obstacles to the creation of international payment routes that need to be taken into account. The restrictions now apply to payments in any currency and there is an increased likelihood that correspondent payments will be blocked by UK banks.

2024: TRENDS

The key events in 2023 suggest that further developments in sanctions regulations and the way they are applied are likely in 2024. Below we outline main trends that we expect to see in current year. These conclusions apply to all the above-mentioned jurisdictions.

1. Strengthening sanctions pressure on jurisdictions "friendly" to Russia

The approach of all the major jurisdictions imposing sanctions demonstrates a focus not only on the expansion of restrictions, but also on measures to curb their circumvention.

Sanctions are often circumvented with the help of persons from jurisdictions "friendly" to the Russian Federation, which are out of sight of the US, EU and UK sanctions regulators. This situation is changing, and there are now increased risks of sanctions being imposed on these persons as well.

In practical terms, this means that sanctions compliance is becoming increasingly important when dealing with counterparties outside of the jurisdictions imposing sanctions.

2. Increase in the number of decisions challenging sanctions designations

In the last two years of the "sanctions storm" we have seen new additions to the sanctions lists on an almost monthly basis. Since the number of sanctioned persons at this point already raises questions, the validity of blocking sanctions is looking increasingly doubtful.

Challenges to sanctions are no longer a rare event, and the number of positive decisions on cases challenging designations against companies and individuals may as well increase. It is also likely that clearer approaches will be formulated for assessing the validity of reasons for designation.

3. Increasing importance of sanctions risk management and compliance

The sanctions, by virtue of their sheer number, are affecting an increasingly wide range of economic sectors and activities, from financial services to IT and intellectual property. New grounds for the imposition of blocking sanctions have appeared. On the other hand, both the number of successful challenges to sanctions and the number of authorizations granted by sanctions regulators for specific transactions and payments are increasing.

Given the above background, the role played by sanctions risk-management and compliance is increasingly important. In 2024, those advising on sanctions compliance issues not only need to address existing risks and track new restrictions in real time, but also to find legal solutions to the problems caused by sanctions.

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We will be happy to answer your questions on this topic.

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