

EU UPDATE: SANCTIONS IN REACTION TO RUSSIA'S INVASION OF UKRAINE

The EU has adopted its 14th package of sanctions targeting Russia. Overall, this package means tighter restrictions, including:

- **prohibitions in relation to Russian liquefied natural gas ("LNG")**, targeting re-exportation, importations and Russian construction projects;
- **tighter anti-circumvention rules**, with a wider scope and a **best effort obligation** on EU parents to prevent their third country subsidiaries from undermining sanctions or circumvent restrictions;
- **reinforced export bans** on chemicals, plastics, vehicle parts and machinery; and
- **larger range of listed entities**, including boats, banks, crypto assets providers, Chinese, UAE and Indian companies.

ANTI-CIRCUMVENTION – Reinforcement of the provisions addressing circumvention risks

- **Best efforts obligation for EU parents to ensure that their third country subsidiaries do not participate in activities undermining EU sanctions:** an EU parent that either owns or controls a non-EU entity should use its influence to prevent such entity from undermining EU sanctions.

An EU operator could be liable for the actions of a non-EU subsidiary over which that EU operator has decisive influence, where those actions undermine EU sanctions. This includes activities resulting in an effect that the sanctions seek to prevent, for example, that a recipient in Russia obtains goods, technology, financing or services of a type that is subject to prohibitions under the Regulation.

Whether an EU entity exerts such "influence" is assessed in terms of ownership, that is a 50% or more threshold for proprietary rights, or a majority interest, or control (defined by reference to certain factors such as managing the business of the subsidiary or power to appoint members of an administrative, management or a supervisory body).

The "best efforts" required depend on the economic operator. Those efforts should include all necessary and suitable actions, while being limited to actions that are feasible for the EU operator with regard to relevant circumstances, such as the sector of operation and country of establishment. In particular, those efforts can take the form of internal policies, controls, and procedures for risk management and mitigation.

- **Clarification of the concept of circumvention:** "circumvention" now also covers "*participating in activities [that have the object of effect to circumvent prohibitions] without deliberately seeking that object or effect but being aware that the participation may have that object or effect and accepting that possibility*".

The extension of the prohibition reflects the Court of Justice's findings in its landmark Afrasiabi judgement (Case C-72/11). Thus, it constitutes an explicit restatement of the state of the law rather than a broadening of the scope of circumvention, clarifying that one cannot, for example, "bury one's head in the sand".

It is also made clear that the benefit of the 'no liability' provision of the Regulation cannot be invoked by those who have not carried out adequate due diligence. Economic operators must therefore, at a minimum, be in a position to demonstrate they have carried out verification on the basis of publicly available information. Conversely, where 'simple checks or inspections' have not been carried out, an EU operator accused of a sanctions breach would be barred from invoking the 'no liability' provision.

- **Due diligence requirements for the sale of certain high priority goods (i.e. battlefield goods) to prevent risks of re-exportation to Russia:** EU operators should be able to identify, assess and mitigate risks of re-export of such items to Russia and, consequently, such assessments must be documented and kept up to date.

Where an EU operator owns or controls an entity in a third country, that EU operator is also required to ensure that that entity implements those requirements too. Nevertheless, the Regulation also clarifies that this requirement only applies to the extent that the legislation of the third country in which the entity is established allows.

The 'No-Russia' clause would be considered as satisfied where contractual prohibitions are included, that include effective remedies and means of redress in case of breach.

- **"No-Russia" clause also for transfers of IP rights:** EU operators must include in their contracts with third-country parties, a prohibition on the re-exportation to, or the use in, Russia of their transferred IP rights (e.g. know-how).

ENERGY SECTOR – New restrictions related to Russian LNG

Prohibitions on:

- **Re-export of Russian LNG via EU ports and related technical services:** the prohibition covers ship-to-ship and ship-to-shore transfers, as well as re-loading operations. It will apply after a 9 month transition period. A derogation may be granted for the re-export of LNG where the destination of the vessel is to another Member State.

Gas, in any physical state, is a fungible good. The approach taken by sanctions on fungible goods and fungible choses in action thus far (e.g. shares of a sanctioned entity entering a pool of security) is that the goods targeted by sanctions affect the whole.

Thus, if an EU entity imports Russian LNG but then sends out a reload cargo from the same tank (as unsanctioned gas, e.g. even if accounted for as gas from an unsanctioned third country), it will potentially breach the sanctions. At least in theory, this would cause a compliance problem for every other company with gas in that tank and, as a result, would be likely to give rise to disputes. Compliance aspects of contracting, technical operations, record-keeping and reporting is therefore likely to be subject to renewed focus in respect of all European reload cargoes.

Likely in order to address these practical issues, the Regulation envisages that national authorities will issue guidance, which will include enhanced due diligence requirements in particular for the identification of reloading services provided for the purpose of transshipment operations, taking into account specificities of the national regulatory framework applicable to liquefied natural gas facilities, indications of direct commercial connections between the unloading and reloading, including the purchase of new unloading and reloading services in bundle, and the country of registration of the economic operators involved.

- **Imports of Russian LNG into specific terminals** not connected to EU gas pipeline network.
- **Provision of goods, services, technology and new investment to LNG construction projects in Russia** (e.g. Arctic LNG2 or Murmansk LNG). EU operators will be required to conduct due diligence to ensure that exported goods and services will not be used for the construction of Russian LNG facilities. The prohibition also covers technical and financial assistance related to goods and services used for the completion of such projects.

FINANCIAL SERVICES – New prohibitions and listed entities

Prohibitions on:

- **Use of the Russian equivalent of SWIFT by EU banks outside of Russia (SPFS):** EU banks cannot use SPFS or any equivalent financial messaging service developed by the Central Bank of Russia.
- **Transactions between EU operators and listed third country banks using SPFS** (list to be determined).

Generally, the prohibitions on SPFS or equivalent financial messaging service developed by the Central Bank of Russia do not apply to entities operating in Russia (e.g. Russian subsidiaries of EU parents). The prohibitions include a few exceptions, including for the enforcement of an EU judgement or arbitration award, or reception of payments due for performance of contracts prior to 24 March 2024.

The prohibition marks a further shift in EU sanctions, increasingly progressing towards US secondary sanctions-type prohibitions, although not yet as clearcut and automatic.

- **Transactions with listed Russian and third-country banks and crypto providers** when such entities facilitate transactions that support Russia's defence-industrial base (list to be determined).

DISPUTE – New mechanisms

- Creation of a legal basis for EU operators to **recover, in the EU, damages** caused by Russian companies as a result of **sanctions or expropriation**.
- **Full ban** on direct or indirect transactions with Russian companies **meddling with arbitration agreements and jurisdictional** rules or agreements.

This new prohibition comes in reaction to Russian legislation No. 171-Φ3, which allows Russian commercial courts to assume jurisdiction in disputes involving Russian entities subject to sanctions, including where the latter have entered into specific dispute resolution mechanisms providing for a place of dispute outside of the Russian Federation (where sanctions apply). For the full transaction ban to apply, the Russian entities making use of the law will have been specifically designated in the Regulation.

In effect, the ban will prevent commercial settlement of a claim with a Russian entity because, in most cases, the Russian party will have applied for an anti-suit injunction, a relief or a form of security against assets owned by European economic operators in Russia before a Russian commercial court.

TRADE – Extension of restrictions and listings

Provision of services:

- **Extension of the exemption for the provision of certain business and management services, and software to Russian subsidiaries:** the exemption for the provision of such software and services by an EU operator for the exclusive use of its Russian subsidiary or subsidiary of a Partner Country Entity, has been extended to **30 September 2024** (instead of 20 June 2024).
- Possible **derogation** for supply of goods and services up to **31 December 2024** for the **divestment** from Russia or **the wind-down** of business activities in Russia: this derogation will depend on the authorisation of national authorities, where specific conditions are met.
- New **exemption** for the provision of services by **employees of Russian subsidiaries:** the provision of certain business services by EU nationals employed by a Russian subsidiary and residents of Russia prior to 24 February 2022, is exempt, provided that such services are for the exclusive use of the subsidiary.

Export:

- **Extension of export restriction relating to dual use and advanced technology items:** the new items include quadbikes and digital flights data recorders.
- **Reinforcement of export bans on industrial goods in four key sectors:** chemicals (e.g. manganese), plastics (e.g. all cellulose products and derivatives), vehicle parts and machinery (e.g. electrical or video/audio equipment).
- **Newly listed Russian and third country entities associated to Russia's military-industrial complex:** the list includes entities from various countries such as India, Türkiye, Kyrgyzstan, Kazakhstan, UAE, China or Hong Kong.

Import:

- Extension of **high priority items list** linked to defence and security: the new items include machining centres for working metal, numerically controlled horizontal lathes including turning centres for removing metal and milling machine for metals (new annex XL).
- Import ban on **stolen Ukrainian cultural items**, and on **helium** from Russia.
- **Clarification** of import ban on Russian **diamonds:** inclusion of a grandfathering rule for diamonds located, polished or manufactured outside of Russia prior to the ban; an extension of the sunrise period until 1 March 2025 for the full traceability scheme of rough diamonds to become mandatory; a postponing of the ban on jewellery incorporating Russian diamonds processed in third countries outside of Russia, until the G7 decides to pursue that measure.

TRANSPORT – Reinforcement of restrictions

- Extension of **flight restrictions:** this includes a ban on non-scheduled flights if a Russian person can decide the origin or destination, as well as an obligation to provide information on non-scheduled flights. (including on the ultimate beneficial owner and the passengers).

- Stricter prohibition on **road transport** of goods in the EU: EU companies owned at 25% or more by Russian person can no longer transport goods nor be allowed to be an EU road transport company.
- Prohibition on **access to ports** and **services for vessels** listed for their contribution to the Russian warfare: 27 vessels listed so far, covering various sectors (e.g. transport of military equipment, of stolen Ukrainian grain or of Russian oil, especially as part of a dark fleet circumventing the oil price cap set by the EU and Price Cap Coalition, including or the re-export of LNG).

OTHER

- Prohibition on **political parties** and other organisations (**e.g. media services**) from accepting **funding** from the Russian state and its proxies.
- Restrictions on the **registration of IP rights** in the EU by Russian persons and persons resident in Russia: EU and national IP authorities cannot accept an application for the registration of IP rights (e.g. trademarks and patents) from Russian persons or residents of Russia.
- **Iceland and Liechtenstein** added as **Partner countries** that apply equivalent restrictions on Russia and benefit from various exemptions. To date, the list already includes the USA, Japan, the UK, South Korea, Australia, Canada, New Zealand, Norway and Switzerland.
- Further **newly listed** entities from various sectors (e.g. space engineering, or actors involved in disinformation supporting Russia's war against Ukraine).
 - Certain new derogation grounds allowing the release of frozen funds have been added, upon verification of the nature and characteristics of the transfer of such funds and provided that they do not result either in making frozen funds or resources available to listed entities, or in circumvention. Funds or economic resources held by central security depositories are excluded from the derogation grounds.

Gide's International Trade & Regulation team in Brussels and Energy and Taxation team in London will provide further updates and guidance as matters continue to unfold.

Our Team will gladly assist you should you have questions or need legal assistance in ensuring compliance when dealing under the newly adopted sanctions.

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