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## COMPLIANCE & INVESTIGATIONS

### FOREIGN TRADE LAW IN GERMANY: RISING COMPLIANCE REQUIREMENTS IN BUSINESS WITH RUSSIA

German companies' business with Russia continues to grow. At the same time, however, the legal hurdles for such business are increasing as well. A complex regulatory environment exists in which some provisions overlap or even conflict with each other. Since 2014, the European Union has been imposing sanctions due to Russia's annexation of the Crimea, and these sanctions were renewed for a further six months in December 2018. The US recently tightened its sanctions again, and these may also impact German companies as they have extraterritorial effect. In turn, Russia has reacted with counter-measures that may likewise have a major impact on German companies.

This increases the complexity of compliance requirements in business with Russia under foreign trade law. European and US sanctions differ in many details. It is imperative to keep checking business partners' current links to listed persons, as both the EU and the US's list of sanctions are subject to ongoing additions or changes.

#### 1. EU sanctions on persons or goods – restrictions on financial instruments

Currently, the EU regulations cover a list of 150 natural persons as well as 40 entities. Listed persons are banned from entering or transiting the territory of the European Union, and their funds are frozen.

For German companies, the most important element in sanctions on persons is the ban on making funds or economic resources available (*Bereitstellungsverbot*). This makes it impermissible for listed persons to be provided with or to benefit from funds or economic resources either directly or indirectly. The same applies to organizations or entities owned or controlled by listed persons. To prevent circumvention, there is also a ban on delivery to an undertaking owned or controlled by a listed person.

- › An undertaking is *owned* by a listed person if, for example, that person possesses more than 50 per cent of the property rights or has a majority shareholding.
- › The question of whether an undertaking is *controlled* by a listed person is a much more complex one, however. Here, it is necessary to check several factors including whether the listed person holds a majority of voting rights either alone or through agreements with other shareholders, or whether on this basis the listed person is able to exert a controlling influence on the undertaking's management, administration or supervisory bodies.

Exceptions to the ban on making funds or economic resources available are only possible within narrow limits. This is the case where it can be ensured individually that the listed person will neither use nor benefit from the funds or resources. It is mandatory for German companies to comply with the ban on making funds or economic resources available. Any violation of the ban is punishable under section 18(1) no. 1(a) of Germany's Foreign Trade and Payments Act (*Außenwirtschaftsgesetz*).

Under certain circumstances, exporting dual-use goods to Russia is also prohibited in its entirety. Dual use goods are those that can be used for both civilian and military purposes. Direct or indirect delivery of dual use goods to undertakings or persons in Russia is banned whenever these are or could be either wholly or partially intended for

military purposes or a military end user. In contrast to deliveries of dual use goods in other countries, such deliveries to Russia cannot receive approval. Technical assistance and financial services connected to dual use goods are also ruled out. It is possible, however, to obtain exemptions from such restrictions for agreements concluded before 1 August 2014 or 12 September 2014, as well as for ancillary contracts needed to fulfil such agreements. These can be approved by Germany's Federal Office for Economic Affairs and Export Control (BAFA).

Finally, exporting goods required for oil exploration and extraction as well as certain services involved in this also require prior approval by the Federal Office for Economic Affairs and Export Control.

In addition to these sanctions on persons and goods, the EU has also issued bans on trading using certain financial instruments. There are sanctions in place on various undertakings in the Russian banking, defence and energy sectors (listed in the EU regulations), as well as on undertakings established outside the EU in which these listed undertakings have majority ownership, and on other undertakings acting on behalf of or as instructed by the listed undertakings. These bans may for example cover certain instruments for financing exports, such as guarantees and letters of credit. Less obviously, but of particular relevance in practice, target payment dates and deadlines that exceed 30 days, or their extension, may constitute a regulatory violation if they are not customary in business.

## **2. Current trends in US sanctions – increasingly, Germany companies may be affected as well**

In 2014, at almost the same time as the EU, the US also issued executive orders for major economic sanctions on Russia, likewise in response to the Ukraine crisis. Their content and scope is comparable with those of the European sanctions, but the details do not coincide. For example, not all persons subject to EU sanctions are on the American SDN (specially designated nationals) list. Vice versa, the US's SDN list includes persons that the EU does not include.

For German and European companies, these US sanctions (termed primary sanctions) may apply directly if such companies make payments in USD or, more generally, US banks are involved in processing the payment, or if US "persons" are involved (i.e. natural persons with US citizenship, Greencard holders, US companies and all natural persons for as long as they are on US territory). Moreover, US sanctions also apply directly to German and European companies if American products, or products with a certain minimum US component are re-exported, i.e. are delivered to Russia from Germany. In this case, US export controls apply just as they would to primary exports from the US.

More controversially – since it is largely out of step with European instruments for sanctions – another current development is evident in the US's Russia policy. In 2017, the US Congress passed the Countering America's Adversaries Through Sanctions Act (CAATSA), which also provides for what are termed secondary sanctions. These cover persons from third countries. Here, no direct connection to the US is required (as would be the case for primary sanctions). The US may therefore, for example, proceed against persons who knowingly undertake or facilitate "significant transactions" with listed persons, their children, partners, parents or siblings, or who engage in business with persons belonging to the Russian defence and intelligence sectors, or who are involved in Russian energy pipeline expansion by exporting goods or providing services. For German companies, therefore, it is recommended that they keep track of this sanction list too and integrate it into IT-supported sanction list screening, which companies generally use – or should use – in their compliance management. Important: under US law, agreements with Russian business partners that originally were unproblematic are no longer permitted to be continued either; in contrast to EU sanctions law, existing agreements are not protected.

In practice, the extraterritorial application of US law exhibits a considerable deterrent effect, as any party violating these provisions could face exclusion from the American market or substantial fines.

## **3. Russian counter-measures – major legal uncertainty**

A further point that German companies should note in their Russia business concerns Russian counter-measures to the EU and US sanctions referred to above: Russian law does not recognize the American or European sanctions. Nor do Russian courts view Western sanctions as *force majeure*; so premature termination of an agreement owing to sanctions could entail claims for damages against the German company.

In response to the Western sanctions imposed in 2014, Russia also issued an import ban on agricultural products, food and drink, and raw materials, as well as an entry ban on politicians, military personnel, and people from the business community, who were placed on what was initially a secret list. In June 2015, a version of the list became public, including persons from the US, the EU, Canada and Japan. Russian courts comply with these sanctions. So if a Russian business partner refuses to meet its contractual obligations by invoking the current sanctions against Russia, the German company concerned will be unable to defend itself in court.

In response to the US's latest sanctions, the Russian government has also brought in new counter-measures in addition to the above. In Summer 2018, two new draft bills were introduced in the Russian State Duma. Initially, both contained drastic measures such as making implementation of foreign sanctions a criminal offence and introducing new import bans. Although these measures were watered down in the course of the legislative procedure owing to protests from Russian businesses, there still exists major legal uncertainty for German companies: it is hard to predict from the legal basis what exactly will be decided or how the legislation will proceed. Nor has the option of making it a criminal offence to comply with foreign sanctions been wholly ruled out. This concerns the following two laws:

- › The "Law on measures (countermeasures) against unfriendly actions of the United States of America and other foreign countries" entered into effect on 4 June 2018. Although it does not provide for any specific measures, as a framework law it gives the Russian president the option of imposing further import bans on products from "unfriendly states" without any legal time limit. "Unfriendly" is defined here as states that undertake "unfriendly actions" against Russia or Russian persons and citizens, as well as the US. This definition is very broad and allows the Russian president substantial political leeway. For German companies, therefore, there is a potential risk that they might in future be deemed "unfriendly".
- › A second draft bill expands the *Russian Criminal Code* to include a ban on compliance with foreign sanctions. This ban is to apply not only to Russian natural persons but *also* to foreign citizens; its violation is to be punishable by a prison sentence of up to four years. Although Russian business has resisted this far-reaching criminal liability, and the bill's second reading in parliament was postponed in May 2018 and has yet to take place, it cannot be ruled out that the act will still be passed. This would entail severe consequences for German and European companies' Russia business, as it will put the representatives of German companies at risk of criminal liability.

#### 4. Conclusion

Companies with Russian business relationships are now finding themselves in a complex web of requirements from different sources and with conflicting effects. To avoid criminal liability and economic restrictions, it is imperative to be aware of the mechanisms of sanctions and to implement a corresponding compliance management system (including efficient business partner screening). In particular, this needs to take account of the differing details of the European and American regulations on sanctions and their ongoing amendments. On top of this, Russian counter-measures also need to be considered. The existing legal situation in Russia and possible tougher measures in future create major legal uncertainty. For this reason, German companies need to keep an eye on current legal developments in Russia, and to continue doing so.

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