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Gleiss Lutz

28.02.2022

FOREIGN TRADE LAW

FOREIGN TRADE LAW UPDATE: UKRAINE CONFLICT – NEW EU AND U.S. SANCTIONS AGAINST RUSSIA ENTER INTO FORCE

The EU imposed far-reaching economic sanctions against Russia on 23 and 25 February 2022 in response to the Russian military's attack on Ukraine. The packages of sanctions include both a tightening and expansion of existing financial and personal sanctions, restrictions on the movement of goods between the EU and Russia, as well as comprehensive territorial sanctions restricting trade and transactions with Donetsk and Luhansk. On 26 February 2022, the EU states and their western allies also decided to exclude already-sanctioned Russian financial institutions from the international SWIFT system and to impose further sanctions on the Russian central bank. The U.S. had also decided earlier to impose additional sanctions on Russia. The sanctions have far-reaching consequences for German companies that do business in Russia.

EU sanctions

On 23 February 2022, as a first step in response to Russia's recognition of the non-Ukrainian government controlled regions of Donetsk and Luhansk, the EU strengthened economic sanctions against Russia by amending/supplementing Regulations (EU) 269/2014 and 833/2014 and also restricted foreign trade with the Donetsk and Luhansk regions (Regulation (EU) 2022/263). On 25 February 2022, following Russia's military offensive in Ukraine, the EU decided to further tighten sanctions against Russia on the movement of goods and money.

- The regulations adopted by the EU include comprehensive **personal sanctions** on a total of, currently, 670 individuals and 55 entities, including the Russian President, the Foreign Minister, members of the National Security Council, the State Duma and individuals who supported the Russian military action from Belarus (see Implementing Regulations (EU) 2022/332, (EU) 2022/269, (EU) 2022/261 and (EU) 2022/261.
  - The scope of Regulation (EU) 269/2014 relating to the annexation of Crimea and Sevastopol has been extended to apply to a greater number of people and entities. Under the new Article 3 of Regulation (EU) 269/2014, these include – most notably – **leading businessmen** and legal persons, entities and bodies in certain **sectors of the economy** that are considered to be a significant source of revenue for the Russian government (cf. Regulation (EU) 2022/330).
  - Persons listed on this basis are **banned from entering and transiting** the territory of the European Union and all their funds and economic resources are being frozen.
  - For German companies, the key element of the personal sanctions is, however, **the ban on providing the above persons** – as well as entities or bodies held or controlled by said persons – **with funds or economic resources**, whether directly or indirectly. The law is worded broadly in order to try and prevent transactions aimed at circumventing it; deliveries to companies owned or controlled by a listed person are also banned, for example.
  - Lastly, visa restrictions are being introduced for diplomats, other Russian officials and businesspeople, meaning that they will no longer be granted privileged access to the EU (Decision (EU) 2022/333).

- The EU is also applying comprehensive **financial sanctions** with the aim of increasing Russia's borrowing

- costs, driving inflation and gradually eroding Russia’s industrial base. The main measures that have been adopted by the EU are as follows:
  - The **trading ban** already in place on certain **transferable securities** and **money market instruments** has been extended. It now also applies in particular to securities and money market instruments issued by **Russia, its government and the Russian central bank**. The ban also covers, among others, **credit institutions and companies** listed in the amended Annexes III, V, VI, XII and XIII to Regulation (EU) 833/2014 that provide material support to the Russian state or operate in the **military or oil industry**.
  - In addition to the securities trading ban, there is a **general ban on granting new credit and loans** to the aforementioned institutions and companies after 23/26 February 2022, respectively.
  - On top of that, there is now a **ban on the sale of euro-denominated transferable securities** issued after 12 April 2022 to **Russian customers**.
  - **It will no longer be possible to trade shares in Russian state-owned companies in the EU**. Regulation (EU) 2022/328 provides for a ban on the listing of, and provision of services in connection with, shares in Russian companies on EU trading venues.
  - Lastly, a **ban on accepting deposits** of more than EUR 100,000 (as legally defined in Article 1(k) of Regulation (EU) 833/2014) from Russian citizens or residents has been newly introduced. One exception to this ban is if the deposits are necessary for non-prohibited cross-border trade in goods and services between the EU and Russia.

- 26 February 2022 also saw the introduction of a of a **general ban on providing public funding or financial assistance** for trade with or investment in Russia. As a consequence, the German government has already announced that it is suspending until further notice the approval of Hermes guarantees and investment guarantees for Russia. This also applies to trade in non-sanctioned goods.

- Where **sanctions relating to goods** are concerned, the EU has also tightened the existing restrictions laid down in Regulation (EU) 833/2014 and added additional provisions (see Regulation (EU) 2022/328):
  - The **export ban on dual-use goods** listed in Annex I of the Dual Use Regulation was tightened to prohibit the direct or indirect sale, export, transfer and supply of *all such goods*. This means that, unlike in the past, the specific (military or civilian) use of the goods in Russia is no longer the determining factor. Exceptions apply only to certain humanitarian uses. In addition, companies can – until 30 April 2022 – apply to the Federal Office for Economic Affairs and Export Control (*Bundesamt für Wirtschaft und Ausfuhrkontrolle*, “BAFA”) for a special licence to export dual-use goods if the goods are intended for non-military purposes and non-military end users, and the delivery serves to fulfil existing contracts that were concluded before 26 February 2022.
  - The EU has introduced a new **export ban** on **goods and technologies** (with or without originating in the EU) that can add to **Russia’s military and technological strength or the development of the defence and security sector**. The affected goods are listed in the new **Annex VII** of Regulation (EU) 833/2014. Exceptions for certain humanitarian purposes apply in this case as well. As with the dual-use goods, companies can – under the aforementioned conditions – also apply for special licences in order to fulfil existing contracts.
  - Moreover, an **export ban** is now also planned for certain **oil refining equipment** listed in the new **Annex X** of Regulation (EU) 833/2014, as well as for **goods and technologies for use in the aerospace industry** (new **Annex XI**). Until 27 May 2022, neither of these bans applies to the execution of existing contracts that were concluded before 26 February 2022. Thus, for the first time, the Regulation also includes a “wind-down period” for the sanctions against Russia during which existing contracts may still – but also have to – be settled.

- Regulation (EU) 2022/263 also now contains a **comprehensive import ban on goods originating in the Donetsk and Luhansk regions of Ukraine**, and a ban on the direct or indirect provision of financing or financial assistance, as well as insurance and reinsurance, related to the import of such goods. An exception applies to those goods that have been granted a certificate of origin by the Government of Ukraine. Moreover, the **trade in** (as well as the export of) **goods and technologies for use in the sectors of transport, telecommunications, energy, prospecting, exploration and production of oil, gas and mineral resources** in the Donetsk and Luhansk regions of Ukraine and the provision of services in these sectors is also prohibited. Likewise prohibited are the acquisition and extension of ownership of real estate or entities and the establishment of joint ventures, including the provision of financing and investment services related to these transactions. An exception to these prohibitions applies to the fulfilment of existing contracts concluded before 23 February 2022, provided that the relevant transaction is notified to the competent authority at least

- five working days in advance. Finally, **services related to tourism activities** in the two regions are also prohibited.

- The tightening of **EU sanctions** is expected to have a **significant impact** on the business that **German/European companies** do with Russia. T**his is due not least to the imposed financial sanctions, which are unique in this form and seek to curtail Russia's access to the most important capital markets. According to EU estimates, these sanctions affect 70% of the Russian banking market as well as important state-owned enterprises, including those in the defence sector.**

U.S. sanctions

At virtually the same time as the EU, the U.S. also issued new sanctions packages and imposed further economic sanctions on Russia. These are very similar to the European sanctions in terms of content and extent, but they are not identical. The main U.S. sanctions include:

- **Territorial restrictions** on trade with Donetsk and Luhansk:
  - Comprehensive **ban on the import of goods from the Donetsk and Luhansk regions** into the U.S.
  - Comprehensive **ban on the export of goods into the Donetsk and Luhansk regions**

- Expansion of **goods-related** restrictions in business dealings with Russia:
  - Export restrictions on all goods produced in the U.S. or manufactured abroad with U.S. technology/U.S. software that are suited for use in the **military sector**.
  - Export bans on **key technologies** in the defence, aerospace and naval sectors. This applies in particular to technologies in the area of semiconductors, telecommunications, encryption security, lasers, sensors, navigation, avionics and maritime technologies.

- Broadening of personal sanctions by expanding the SDN list (natural persons from Vladimir Putin's "inner circle"; in particular the banks VEB and PSB as well as a number of their subsidiaries; Nord Stream 2 AG and its management) with the consequence that no more business may be conducted with these persons.

- Imposition of extensive financial sanctions:
  - **Sberbank**, including 25 of its subsidiaries, cut off from U.S. financial system
  - Comprehensive blockade of the banks **VTB, Otkritie, Sovcombank OJSC and Novikombank** and their subsidiaries by freezing and blocking all the assets of these banks.
  - Ban on the acquisition of and trade in government bonds of the Russian Federation by U.S. financial institutions on the primary market and, starting from 1 March 2022, also on the secondary market; ban on lending to the Russian state or the Russian central bank.
  - **Ban on financing** and engaging in **transactions with 13 of Russia's largest companies** (including Gazprom, Gazprom Neft, Transneft, Rostelecom, Alrosa and RusHydro).

- The **impact of U.S. sanctions** on German/European companies may be significant. On the one hand, U.S. sanctions may also apply to German and European companies directly in the form of export controls (**primary sanctions**). This is the case, for example, where U.S. goods or goods that contain a certain share of U.S. components or are manufactured on the basis of U.S. technology are exported – i.e. supplied from Germany or the EU to Russia. The same applies if U.S. persons, in particular U.S. banks (such as in the case of transactions in U.S. dollars), are involved in the transaction or if the company exporting the goods employs U.S. persons (including green card holders) in a responsible position. Secondly, the U.S. sanctions against Russia also provide for **secondary sanctions** in certain cases. These not only cover U.S. persons or U.S. related matters, but also persons from third countries. A direct link to the U.S. is not necessary.

Exclusion of Russian banks from the SWIFT payment system

- On 26 February 2022, the U.S., Germany and other countries agreed to exclude some large Russian financial institutions from the **SWIFT banking communications network**, with the aim of cutting them off from international financial flows. The ban is initially intended to cover all Russian banks that have already been sanctioned by the international community. Additional Russian banks are to be added if necessary.

- In principle, banks can also communicate without SWIFT (for example, by direct contact via telephone or e-mail). However, this is much more cumbersome, and therefore more time-consuming and costly. The exclusion of Russian banks from the system thus severely restricts them in international transactions.

Conclusion and recommended action

The newly imposed sanctions will have a very significant impact on the activities of German and other European companies doing business in Russia or with Russian business partners. The exclusion of Russian banks from SWIFT, in particular, is likely to lead to far-reaching restrictions on trade between Russia and the West. Although it may still be possible to conduct business through Western banks and their subsidiaries in Russia (insofar as they are still on the ground and able to work), removal from the system will make payments more cumbersome and far more expensive. What's more, further sanctions are likely to follow at any time. The companies affected currently face tremendous challenges as a result: For one, they need to meet increased requirements for export controls and economic sanctions compliance to avoid obstacles to implementation, unexpected delays in scheduling or even criminal sanctions for violations of foreign trade regulations. Companies also need to assess which steps to take with regard to their remaining employees or assets in Russia or Ukraine.

Given these circumstances, companies should urgently review their internal compliance structures, and establish whether sufficient manpower and resources are available to deal with these tasks. Depending on the extent of a company's exposure, it may be advisable to set up an internal task force to manage responsibilities and tasks, and keep reporting lines short.

In particular, companies should ensure they do the following:

- Closely monitor **EU and U.S. sanctions,** their development and impact (in particular, frequently screen for any extension of the EU's sanctions lists).

- **Take the necessary steps to follow the sanctions (compliance management), in particular:**
  - **Contract and licence management for existing contracts**: Review existing business relationships for any newly introduced bans or licencing requirements (possible exemptions for old contracts need to be taken into account in this regard). Export licences already issued by BAFA in the past often contain the very vaguely worded condition subsequent according to which the licence expires if the legal situation that applies to the export transaction changes. We recommend clarifying with BAFA on a case-by-case basis whether the licence is still valid.
  - Conclusion of **new contracts**: Careful review of whether the contract complies with the relevant sanction regulations (e.g. whether it exclusively affects the supply of non-sanctioned goods); inclusion of an additional provision (supplementing the force majeure provisions) to shift the risk of tighter sanctions and the associated risks to execution of the contract to the Russian contracting partner.
  - Continuous risk assessment of whether the company faces disadvantages as a result of the sanctions or the factual situation in Ukraine or Russia, such as the **disruption of business relationships or supply chains** (including, for example, due to increased cyber attacks).
  - Monitoring of possible **de facto payment issues of Russian customers/contractual partners** in connection with probable foreign exchange control in Russia as well as the exclusion of Russian banks from the SWIFT communication system.
  - Review of the extent to which Russian group companies must also observe EU sanctions and the extent to which German or European group companies must observe **U.S. sanctions**.
  - Monitoring of possible measures taken by the Russian side and, if necessary, **protection of assets located in Russia** (also given the possibility of "retaliation" by the Russian government).
  - Review of **duties of care under labour law** with regard to **employees** travelling or posted to Ukraine and Russia (difficulties in leaving the country due to closure of European airspace to Russian and Belarusian aircraft).
  - **Training of employees** with business contacts to Russia and Ukraine.

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EXPERTS

Dr. Burghard Hildebrandt

Dr. Jacob von Andreae

Dr. Eva Koch

Aylin Hoffs

Kristina Müller

Dr. David Schneider