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Foreign Investment Alert²

**Negotiable Hostilities - Part IV:
REXIT Roadmap- Managing Contract and Investment Disputes when Leaving Russia**

I. INTRODUCTION

As the Russian-Ukrainian conflict continues with no end in sight, news accounts of Western companies estimate their losses at over \$59 Billion, a result of the Western sanctions,³ Russian counter sanctions and massive social pressure, a trend we call “REXIT.” In our prior alert, we discussed some of the REXIT pitfalls facing investors and other commercial parties and how to navigate them. We

¹Sapronov Group is a trade name for Sapronov & Associates, P.C. and its affiliate, Sapronov & Naglis LLC.

² While accurate to the best of our knowledge, this discussion is for tutorial purposes only, and is neither a legal opinion nor legal advice. Please contact us if you have any questions regarding this disclaimer.

³ See generally, <https://www.trade.gov/country-commercial-guides/russia-sanctions>.

now continue this discussion – this time with a nuts and bolts discussion of how to manage the inevitable disputes that “REXITERS” should keep in mind.

In this alert (briefly) and in a (more detailed) discussion at our accompanying webinar, we offer practice pointers for transactional attorneys, investors, commercial parties, arbitrators, and litigators seeking to resolve Western-Russian contractual and investment disputes, the respective jurisdictional interpretations of “force majeure,” investment arbitration, choice of law and forum, settlement considerations and deal protections for future transactions. Hosted by Thomson Reuters, our panel, comprised as before of highly experienced attorneys, will address these complex issues from the varying viewpoints of U.S., European, and Russian jurisdictions.

II. SANCTIONS UPDATE

A. Western Sanctions.

Beginning with the Crimean takeover in 2014 and escalating with the Ukrainian conflict, U.S., UK and European authorities have imposed a series of sanctions on Russian banks, state-owned entities, and individuals that also sweep in Western parties doing business with Russia. In response, the Russian Federation has imposed restrictions on certain activities of Russian parties conducting business with Western countries as well as on certain activities of their Western counterparts which happen to be present in Russia. Sometimes, in a Catch-22, compliance with Western sanction can trigger a potential violation of Russian countersanctions.⁴ Both Western sanctions and Russian countersanctions carry severe (possibly criminal) penalties for non-compliance.

As the conflict continues, so does the number and severity of Western sanctions, making cross-border transactions – especially those involving money transfer - increasingly difficult if not impossible.

Briefly, in the U.S., the Office of Foreign Asset Control (“OFAC”) administers a number of different sanctions programs. The sanctions can be either comprehensive or selective, using the blocking of assets and trade restrictions to accomplish foreign policy and national security goals. The list, which includes both countries and individuals, changes frequently.⁵

For U.S. investors and commercial parties, among the more important sanctions were those issued in the U.S. Executive Order 14071 (April 6, 2022), largely prohibiting Western professionals from engaging in business consulting, mergers and acquisitions, and other activities on behalf of Russian entities.⁶ Subsequent clarifications from OFAC imply that legal services do not fall within this prohibition – an important carveout as a REXIT cannot be accomplished without lawyers ensuring its legality under both U.S. and Russian laws.

Some sanctions’ relief is also available from OFAC through licenses. A general license authorizes a particular type of transaction for a class of persons without the need to apply for a specific one. A specific license is a written document issued by OFAC to a particular person or entity,

⁴ See, e.g., <https://www.jdsupra.com/legalnews/russia-s-recent-actions-against-foreign-4249107/> and discussion in Part II infra.

⁵ <https://home.treasury.gov/policy-issues/financial-sanctions/sanctions-programs-and-country-information>.

⁶ Prohibiting New Investment in and Certain Services to the Russian Federation in Response to Continued Russian Federation Aggression, 87 FR 20999 (April 8, 2022).

authorizing a particular transaction in response to a written license application. Thus, depending upon the facts and circumstances, a U.S. person may seek a license from OFAC for dealing with a sanctioned entity.

Noteworthy for U.S. entities continuing to do business in Russia (whether as part of a REXIT transition or longer), OFAC's general license 25B⁷ permits the direct or indirect delivery to Russia of U.S. services, software, hardware, or technology incident to the exchange of communications over the Internet. These include instant messaging, videoconferencing, chat and email, social networking, sharing of photos, movies, and documents, web browsing, blogging, web hosting, and domain name registration services.

B. Russian Countersanctions.

Western sanctions have caused Russia to incur economic losses, consequential disintegration of logistical chains of supplies and an exodus (voluntary or otherwise) of Western companies and Western investments of all kinds.

In response, the Russian Federation has taken measures such as the following:

- Export limitations / prohibitions on certain Russian products;
- Money transfer restrictions and currency controls (*e.g.*, requiring payments from “unfriendly” foreign states to be made in Rubles);
- Warnings to foreign investors considering REXIT options in response to Western sanctions or other “political” reasons;⁸
- Bankruptcy risks for those REXITING companies not demonstrating a “willingness to cooperate;”
- Countersanctions (euphemistically termed “Special Economic Measures”) prohibiting or voiding financial and other dealings with entities named on a countersanctions list;⁹
- Measures ostensibly “protecting” Russian licensees of intellectual property rights owned by foreign licensors; and
- Other Russian governmental actions discussed in III.C. (Addressing Russian Countersanctions) below.

⁷ OFAC License No. 25B; See <https://www.whitehouse.gov/briefing-room/statements-releases/2022/06/02/fact-sheet-united-states-takes-further-actions-to-counter-sanctions-evasion-by-russia/>; https://home.treasury.gov/system/files/126/russia_gl25b.pdf.

⁸ One such REXIT option chosen by many major companies leaving or winding down their operations in Russia is selling or otherwise transferring (via franchising etc.) their business to Russian counterparts, co-owners and investors, usually – with an option to re-purchase.

⁹ Presidential Decree No. 252 of May 03, 2022 (issued in accordance with the provisions of Federal Law on Special Economic Measures and Enforcements Measures No. 281-Ф3 of December 30, 2006). The list of some 31 legal entities (most formerly affiliated with Gazprom) was released at the end of May.

III. SOME PRACTICAL STEPS

Some Western parties with Russian holdings may wish to plan their REXIT by selling them (*e.g.*, through a stock or asset sale (“продажа акций или активов”)) or to simply shut down their operations and repatriate the invested funds. Others may simply move their financial assets elsewhere. As Western Sanctions and Russian Countersanctions continue to grow, all that is easier said than done – and in any event, will not be done quickly. Here is a brief checklist of some practical steps to accomplish this REXIT.

A. Sanctions Diligence.

A recommended first step for Western parties in any cross-border transaction with Russia is “sanctions diligence:” an examination of each of the parties and their Western and Russian affiliates, together with third-party lenders and any Russian person involved in the transaction, all to ensure that they do not fall under the respective sanctions list.

Affected parties should specifically review whether the Russian counter party is on the Specially Designated Nationals and blocked Persons List (“SDN List”).¹⁰ Second, review other sanctions (*e.g.*, sectorial sanctions) and apply to the transaction.¹¹ If neither apply, then that concludes the sanction diligence and one can move on to the next steps.

However, if a counter party shows up on a sanctions list or is otherwise implicated thereby, then it is still possible to explore other relief measures – notably in the form of a license to deal with the sanctioned counter party. (See discussion in Part IIA. *infra.*) Review whether either a general license is available from OFAC or, if not, consider applying for a specific license from OFAC permitting dealings with a sanctioned counter party.

B. Moving the Money.

As indicated, one of the most difficult REXIT tasks is the exchange of money to and from Russia.

Not only do sanctions and other restrictions make international currency transfers exceedingly difficult, there is also some risk that the transfer will be stopped on either the “Western” or (less likely) the “Russian” side of the transaction, leaving the money in limbo. Reasons include the legal restrictions on sanctioned Russian Banks, the hesitation or unwillingness of Western financial institutions to have any dealings with Russia, and other cross-border financial regulations (*e.g.*, money laundering, know-your customer (KYC)). Moreover, the U.S. Financial Crimes Enforcement Network (FinCEN), OFAC, and the Department of Justice and have now formed a task force with foreign Financial Intelligence Units, specifically targeted at Russian oligarchs circumventing sanctions or otherwise hiding illicit wealth.¹²

¹⁰ <https://home.treasury.gov/policy-issues/financial-sanctions/sanctions-programs-and-country-information/ukraine-russia-related-sanctions>.

¹¹ <https://sanctionssearch.ofac.treas.gov/>.

¹² <https://home.treasury.gov/news/press-releases/jy0800>.

Any such money transfer, in short, is difficult, illegal ones can result in criminal liability, and any suspicious transfer, even if legal, may be stopped. Here are some suggested steps for dealing with this hurdle.

First, review the current currency controls and international wire transfer restrictions on the exchange of funds between Russia and Western parties. If the transfer is permitted, resume sanctions diligence.

As of this writing, Western sanctions have swept in most of the large Russian Banks, making it illegal for Western parties to accept their money transfers. An indirect result is also the “Russophobia” (or perhaps “Riskphobia”) of Western Banks that, in an abundance of caution, refuse to have any dealings with Russian banks, whether sanctioned or not. Ideally, if one is dealing with a non-sanctioned bank, it should be theoretically possible to find a Western Bank willing to engage in such a transfer.

Sadly, that is often not the case. That leaves limited options for direct U.S.-to-Russian bank transfers and points to the advisability of seeking an independent, third-party country as an intermediary. Consequently, if a U.S. or Western financial institution is unavailable for the “Western side” of the currency transfer, consider using another jurisdiction (*e.g.*, Dubai).

Second, regardless of jurisdiction, the Ruble-U.S. Dollar/Euro currency ratios vary daily – with restrictions and controls by the Russian Federation on payments for Russian assets. Western funds transfers to Russia often requires a currency conversion to Rubles, considered by Russian tax authorities to be a taxable event. Consequently, even a successful financial transaction should contemplate the Dollar (or Euro) to Rubble conversion rate, the potential tax, and provide a “true up” clause in the underlying contract in anticipation.

C. Addressing Russian Countersanctions.

On the Russian side of the transaction, REXITING parties must exercise a parallel, counter-sanctions-diligence procedure.

Among the risk factors are legislative developments and executive actions by the Russian Federation including (i) pending legislation in the State Duma providing, as a possible sanction for stopping operations in Russia, court enforcement of “external administration” (somewhat akin to a U.S. involuntary bankruptcy type procedure) for companies from “unfriendly states and territories where the Western companies’ activities in Russia are considered important for the state;”¹³ and (ii) licensing restrictions on the transfer of shares or foreign currency to parties from “unfriendly states and territories.”¹⁴ Other matters requiring diligence include possible criminalization of actions by Western individuals performing (permanently or temporarily) management functions in Russian companies that could be viewed as “committed for the purposes of fulfilment” of Western sanctions against Russia.

Moreover, there are cryptocurrency and other currency transfer regulations in Russia, including recently increased limits by the Russian Central Bank for Russian and foreign citizens transferring

¹³ Draft Bill NO. 104796-8 (April 12,2022) (Still pending as of this writing).

¹⁴ Presidential Decree No. 81 (issued March 1, 2022) as amended by following Decrees.

money abroad and fluctuating U.S. Dollar to Ruble conversion rates. All of these bear close monitoring by affected parties.

IV. RESOLVING THE INEVITABLE DISPUTES.

As discussed in our prior alert, contract termination and business shut-down by Western companies under REXIT conditions can result in severe penalties – both contractual and a possible seizure of assets (or worse).

For instance, as a defense to termination penalties, common law defenses such as force majeure would likely be raised in a Western forum. Whether or not the current Ukrainian conflict (or the sanctions resulting thereby) would relieve a party from performance under force majeure grounds will depend on the specific wording of the contract and the governing law. Under Anglo-American jurisprudence, force majeure is a common-law doctrine, typically requiring that “war” or “threat [thereof]” be expressly included in the force majeure clause - along with possible mitigation obligations on the party relying on such event as an excuse or delay of performance. The current conflict and related sanctions may or may not satisfy these criteria.

The Russian law concept of force majeure seems to be generally narrower than its counterpart under US law. When Western sanctions hindered or stalled a substantial number of contractual relations involving Russian persons and entities, the Russian concept proved inapplicable to many sanctions’ related disputes. A supplementary legal mechanism has been proposed in pending Russian draft legislation.

Finally, REXIT disputes are all but inevitable, and often likely to be resolved through international arbitration. For investors, possible relief may be found in protections available under bilateral investment treaties concluded by Russia and/or Ukraine. Further, the Russian Federation is a signatory to the New York Convention, thus providing at least a possible procedural mechanism for enforcement of an arbitral award in favor of a Western party (assuming there are reachable assets) but one that would otherwise not likely be recognized in a Russian jurisdiction.

Our upcoming webinar – a continuation of the last one in our “Negotiable Hostilities” series, will include a discussion of these complex topics. Please join us on June 22, 2022 at 10 a.m. Eastern. The webinar will be moderated by Walt Saponov of our firm and James K. Wholey, Phillips Lytle LLP. Speakers include Alla Naglis, Saponov & Naglis, LLC; Gisele Stephens-Chu, Stephens Chu Dispute Resolution; and Yuri Lebedev, Saponov & Associates, P.C.

For additional details and to sign up, please visit https://westlegaledcenter.com/program_guide/course_detail.jsf?videoCourseId=100324891&ADMIN_PREVIEW=true.

We hope to see you there – and we continue to pray for peace between Russia and Ukraine.