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“Fireside Chat”
Dealing with Russia in the Current Geopolitical Environment



NEGOTIABLE HOSTILITIES
Navigating the Road Out of Russia

(Updated January 8, 2024)

Suggested Discussion Topics in Q&A Format¹

A. What are some of the Current Western Sanctions, Russian Counter-Sanctions, and Other Complications in Dealing with Russia today?

- First, a caveat. Our practice in Russia is focused on cross-border transactions and finance. My responses are thus based on practical considerations and on our experience in this specialized practice area. We do not purport to comment or give advice about foreign policy or geopolitical trends generally.

- Also, additional details regarding Western Sanctions, Money Laundering Enforcement Measures; Russian Counter-Sanctions, and their transactional implications for cross-border financial transfers are discussed in our series of Alerts/Webinars (sponsored by Thomson Reuters West LegalEd Center). See <https://wstecomlaw.com/2023/08/negotiable-hostilities-webinars/>.

1. Briefly describe the U.S. agencies and key administrative procedures charged with sanctions enforcement and related anti-Russian enforcement actions.

- U.S. Sanctions are imposed by the Office of Foreign Assets Control (“OFAC”), an agency of the U.S. Treasury Department. OFAC has a website that lists all of the so-called “Specifically Designated Nationals” (“SDN List”), including both institutions and persons, subject to sanctions. The assets of entities on the SDN List have generally been blocked and U.S. persons are generally prohibited from dealing with them. Failure to comply with sanctions (i.e., engaging in transactions with individuals or other entities on the sanctions list) carries very serious monetary and criminal penalties. For more specifics about Crimea or Ukraine-related sanctions, one should check the SDN List on www.ofac.treasury.gov.

- Related U.S. governmental actions included expanded money laundering enforcement actions. These are promulgated and enforced by the Financial Crimes Enforcement Network (FinCEN) (<https://www.fincen.gov/>). There are both federal and state international money transmitter laws that, with some exceptions, require licensing for the exchange of money between Russia and the U.S. These include “know your customer” (KYC) and money-laundering regulations as authorized under Title III of the U.S. Patriot Act. failure to comply is a criminal offense.

¹While accurate to the best of our knowledge, the discussion herein is for tutorial purposes only. It is not to be deemed a legal opinion or legal advice. Should you wish to discuss this disclaimer, please contact us at wsapronov@wstecomlaw.com

Importantly, expanded U.S. corporate ownership disclosure requirements have recently been added to both OFAC sanctions and money laundering laws - notably with the FINCEN rules effective January 1, 2024, following the enactment of the Corporate Transparency Act. (CTA), a part of the National Defense Authorization Act that amended the Bank Secrecy Act of 2021. The CTA regulations were expressly adopted to combat sanctions evasion and other money laundering violations by oligarchs and other Russian entities.

3. What are the key U.S. sanctions and related enforcement measures in place today?

- Quite a few – the U.S. Sanctions program has targeted some 200 entities, business sectors, and assets (*e.g.*, vessels) that have “contributed to the situation in Ukraine,” (again, see www.ofac.treasury.gov). The program is authorized by a series of U.S. Presidential Executive Orders, initially focused on the takeover of Crimea in 2014 and continually expanding since then following the Ukrainian conflict that started in February 2022.
- More recently, the recently effective CTA requires all small business entities (so-called “reporting companies”) to disclose their “beneficial owners”. A company “applicant “who makes the filing on behalf of the Reporting Company (*e.g.*, its attorneys) is also required to disclose its ownership. This legislation is expected to affect some 32 million small businesses in the U.S. For established companies, the reports must be filed by December 31,2024, giving established companies a year to comply with these complex disclosure requirements. Newly established companies must make a disclosure within 90 days (in 2024) and thereafter within 30 days. Essentially, this is a comprehensive program designed to identify individuals (including Russian sanctions evaders) who use corporate “shells” to conceal their ownership. The information is to be stored in a beneficial owner information (BOI) database. Failure to comply with the CTA can trigger significant civil penalties (up to \$10,000) and up to two years of imprisonment. Unauthorized use or disclosure of BOI can trigger up to \$250,000 in fines and up to five years’ imprisonment.
- In addition to OFAC sanctions and FINCEN money laundering enforcement, the U.S. has expanded numerous regulatory entry barriers on investments in U.S. technology investments by Russia and other unfriendly states (*e.g.*, China). Among these are expanded CIFIUS regulations (Foreign Investment Risk Review Modernization Act (FIRRMA)), Foreign Agency Registration Act (FARA), and U.S. Commerce Department Supply Chain (ICTS) regulations. In the telecommunications industry, the traditional FCC review of foreign investment has been expanded into a multi-agency review by “Team Telecom,” with particular emphasis on China but certainly applicable to Russian investment as well.
- Still more recently, the Federal Communications Commission (FCC), the agency charged with telecommunications and wireless industry regulation, has

ordered holders of international transmission Licenses (so-called “International 214” authority) to disclose their ownership – with Russian owners to be identified under an “unfriendly countries” list. These Mandatory Updates for International Section 214 Authorization Holders are due by January 22, 2024. Our informal discussion with the FCC indicates that Russian or other “unfriendly” owners will likely be required to divest their interests if deemed to be a national security risk. The rescission of China Telecom’s International 214 authority is an illustrative template for such divestment actions.

- But the most important commercial sanctions, from our perspective, are the pervasive ones on virtually all Russian financial institutions (*e.g.*, SberBank, VTB Bank) together with Russia’s exclusion from the SWIFT network (<https://home.treasury.gov/news/press-releases/jy0608>). Essentially, these sanctions preclude cross-border financial transfers between Russia and the West. Without securing transaction-specific licenses from OFAC, international commercial transactions between Russia and the U.S., as a practical matter, are all but impossible.

4. What are some key Russian Counter-Sanctions?

- Two of the most important are Presidential Decrees (i) No. 302, (dated April 25, 2023) providing a framework for taking over of assets of persons from “unfriendly states”), and (ii) No. 618 (dated September 8, 2022) (with subsequent Guidance, March 27, 2023), requirement payment of a “Contribution” (*i.e.*, an “Exit Tax”) in an amount ranging from 5% to 10 % of the fair market value of the exiting company.
- The first of these (Decree No. 302) essentially authorized the imposition of external Russian management or nationalization of assets on companies owned by unfriendly states. Several European companies have taken over in this fashion.
- The second of these requires approval of a Russian Government Commission for direct or indirect change of ownership of a foreign subsidiary in Russia. A condition to approval is payment of the “Exit Tax.” The problem is that such a payment is currently not permitted under U.S. law without a special license from OFAC – a “catch 22.” While payment by U.S. persons of taxes and similar fees for transactions that are “ordinarily incident and necessary to the day-day operations in the Russian Federation” are permitted (GL License 13(e)), the payment of the Russian “Exit Tax” is not. <https://ofac.treasury.gov/faqs/1118>. An OFAC license application to pay this tax may take up to six (6) months, with no guarantee of approval.

- For more details on Russian Counter-Sanctions, please see Our Negotiable Hostilities Webinar, Part III. (available at <https://wstecomlaw.com/2023/08/negotiable-hostilities-webinars/>.)

B. Prior investments in Russia

- What have US-based companies that had operations or investments in Russia done with these investments?
 - Some have pulled out, some have sold the companies to foreign buyers, others are more or less stuck pending further political development.
- Is it possible to move money out of Russia? What are the challenges?
 - All but impossible. The only alternatives are either transfers to a third country or crypto currency. In each case, a license or informal “no violation of law” opinion from OFAC is highly recommended.
- What are the risks to companies who have exited or are still trying to exit Russia?
 - Confiscation; Nationalization; Criminal prosecution for Russian tax violations; Appointment of Russian directors (*e.g.*, Kadyrov’s nephew) to Russian subsidiaries of foreign companies.
- What are available mechanisms for dealing with investment disputes?
 - See our Negotiable Hostilities Webinar, Part III, Investment Treaty Arbitration.

C. Long-term outlook for sanctions

- Broadly speaking, when have economic sanctions worked? What’s their track record of success?
 - In terms of a material impact on the Russian economy, no. See Professor Adam Stulberg’s presentation at our Negotiable Hostilities Webinar, Part III.
- Why do sanctions fail?
 - Russia lost 20 million people in the fight against Nazi Germany in World War II. They perceive the Ukrainian government to be the successors to that regime. They will not likely surrender because they cannot import French wine and cheese.
- When are sanctions likely to succeed?
 - My guess is never. They do not affect the elites. Only small businessmen like us.

D. What’s next??

- Do Western sanctions have any specific terms under which they would be removed?
 - U.S. Treasury Secretary Yellin says they will stay in place even if there is a peace treaty or settlement.
- As a practical matter, would the end of hostilities in Ukraine be enough to end sanctions?
 - Probably not. See comment re: Secretary Yellin above.
- What are scenarios that could cause lifting of sanctions?

- A truce – like the one that “ended” the war in Korea in 1953?

Specifically, the Korean Conflict analogy is the one that readily comes to mind. Representatives from the People’s Republic of China (Zhou Enlai) and the U.S. Secretary of State (Dean Acheson), attempted to negotiate an end to the conflict and prolonged it for two and a half years. Eventually, with the anticipated election of President Eisenhower – and the implied threat of a possible nuclear escalation – the two sides agreed to a ceasefire, one that was not signed by the South Korean President Rhee (but who agreed to comply with it). A parallel today would be a negotiation between U.S. Secretary of State Blinken and Russian Foreign Minister Lavrov – one not yet on the horizon. Whether Ukrainian President Zelensky would agree to any settlement that relinquishes Ukrainian territory to Russia is at least questionable.

- Formal peace treaty? Is this likely?
 - NO
- Regime change in Russia? Is this likely?
 - NO. (See, *e.g.*, Wagner Group Prigozhin’s ill-fated attempt mutiny – and its consequences)
- Would Western sanctions likely fade over time as countries struggle to maintain a unified approach?
 - Not sure. But at the very least, dismantling them will require much administrative effort (*e.g.*, vacatur of Executive Orders, adoption, or reconsideration of codified regulations, *etc.*). Passing a regulation under the U.S. Administrative Procedures Act typically takes at least a year and sometimes much longer (requiring procedural due process, notice and comment, creation of a record upon which a decision may be based, and agency rule adoption).
- Are Western companies likely to return to doing business in Russia in the future?
 - Russia no. Ukraine yes. Think “lend-lease” and Marshall Plan post WWI. Recently, the U.S. Chamber of Commerce in conjunction with the U.S. Commerce Department organized a conference reaching out to U.S. private enterprises to invest in Ukraine reconstruction.
- Any considerations for companies that eventually might consider returning to Russia? Limit risk that investments can be seized with “capital light” strategies? Use joint ventures or minority stakes to reduce risk (and also reduce upside)? - Here are a few thoughts based on our transactional experience.
 - Foreign project finance transactions, popular in the late 1990’s and early 2000’s, provide a template for such an infrastructure development projects. They typically involve a U.S. Sponsor and various investors (*e.g.*, Vendor finance, syndicated loans, high yield indenture).

- In the case of high political risk (as in Ukraine), deal protection would entail security agreements – with the collateral or “crown jewels” (*e.g.*, IT rights, spectrum rights) placed in a U.S. bankruptcy remote entity (a “LicenseCo”). Investor recourse would then be to a familiar U.S. entity (typically a Delaware corporation) with transfer of IP or other Ukrainian assets approved by Ukrainian authorities. Complicated – but could be done.