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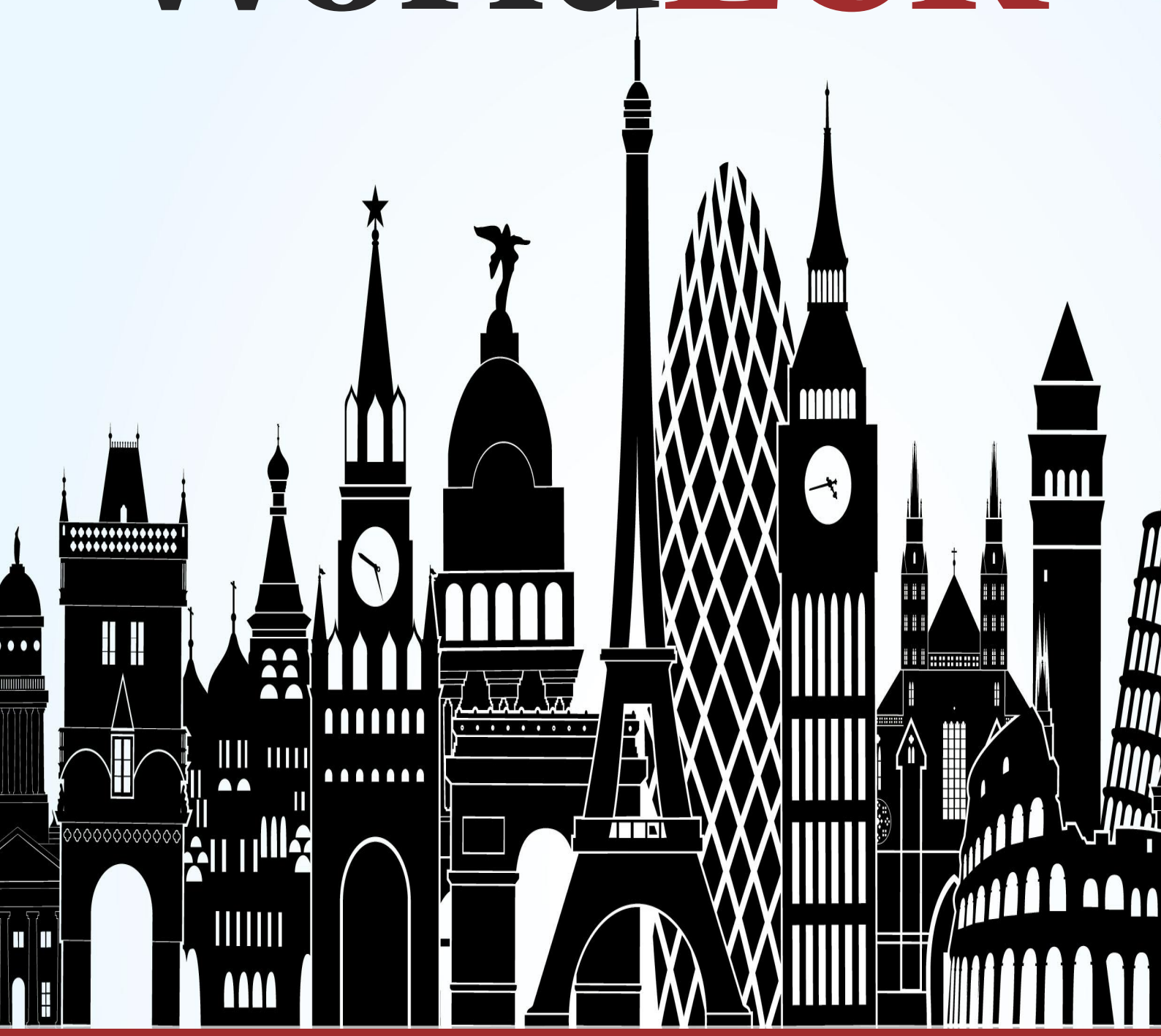

SPECIAL FOCUS

EUROPE 2015

In 2014, conflict in Ukraine put EU sanctions and export controls firmly on the European corporate compliance agenda. In this Special Focus, *WorldECR* speaks to the lawyers advising on the impact of the regulations and the challenges facing business – and the regulators – in the year ahead.

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SANCTIONS

FROM MEGARA TO MOSCOW

The imposition of restrictive measures on Russia has extended the reach of sanctions well beyond the geographies typically affected. But while over-stretched authorities may appear to lack the resources to address the myriad compliance-related questions that the measures have raised, sanctions, authored both in Brussels and Washington, are increasingly finding a place on the compliance agenda.

Around 430 BC, the statesman Pericles persuaded the Assembly to impose a law that would prohibit tradespeople of the nearby town of Megara from doing business in Athens. The given reason for the Megarian Decree was that the inhabitants had offended the goddess Demeter. The real cause, intention, and consequences of the edict have been debated by classicists from Thucydides onwards. Athenian merchants, said Aristophanes in *The Acharnians*, cared little for all that, merely grumbling that it was no good for the trade in pigs, fish, and figs.

In 2004 another assembly, that of the Council of the European Union, published its Basic Principles on the use of sanctions, laying out how the EU would use restrictive measures (sanctions) both to 'maintain and restore international peace and security in accordance with the principles of the United Nations Charter,' and also with those of its own common foreign security policy ('CFSP'.)

To those ends, it would both ensure timely implementation of UN Security Council measures, and impose its own autonomous EU sanctions 'in support of efforts to fight terrorism and the proliferation of weapons of mass destruction and as a restrictive measure to uphold respect for human rights, democracy, the rule of law and good governance'.

If the Megarian Decree established a classical authority for – and some perennial truths about – sanctions, the Basic Principles set out the policy gridlines within which EU

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policymakers have been framing and imposing sanctions, both as extensions of the will of the Security Council and expressions of the CFSP.

Sanctions step up

In the past ten years, they've had plenty of practice at both as the EU has responded to an increasingly broad gamut of foreign policy challenges: Iranian proliferation, the civil war in Syria, human rights in Belarus, unrest in Cote d'Ivoire, Yemen and so on. Indeed, the United States is even included in the list, in so far as that blocking regulations prohibit compliance by EU parties with the Cuba sanctions.

'Merely because of the volume of trade with Russia, a lot more industries are now in touch with sanctions than before.'

Yohan Benizri, Sidley Austin

Of course, the sanctions *regime de jour* is that of the restrictive measures against Russia, Council Decision 2014/512/CFSP and Council Regulation (EU) No 833/2014 of July 2014 which, like their U.S. equivalents, impose restrictions on energy transactions, financial transactions and break new ground in that they effectively impose export controls in addition to imposing sanctions on an increasingly long list of Russian banks, businesses and individuals.

Russia remains the EU's third most important trading partner, while the EU is Russia's first trading partner. In 2013, trade in goods between the two had the total value of around 330 billion euros. By way of illustration, in 2011, before the restrictive measures choked off relations with the country, EU trade with Iran hit around 30 billion euros while just three years later, it had reduced to around six billion euros.

Trade lawyers interpret the comparative impact of the regimes in different ways: 'Merely because of the volume of trade with Russia, a lot more industries are now in touch with sanctions than before. Some are still very green and need to be talked though the basics of sanctions compliance. Others are more sophisticated, and are addressing increasingly complex questions and very detailed aspects of compliance,' says Sidley Austin's Yohan Benizri.

'Detailed', not least, because the measures published in September imposed considerable restrictions on financial transactions with some Russian parties, but left clients, and indeed Member States, to interpret what they meant in practice. The Commission did publish guidance in late December – which afforded welcome, but partial relief – but it was long overdue.

Jessica Gladstone, international counsel at law firm Debevoise in London, gives a flavour of some of the issues that she and colleagues have been called to advise on: 'The sanctions affect all loans, both new and existing. So the kinds of things that come up are questions like: When do sanctions trigger illegality clauses? When can banks call up their loans because of an "illegality" event? Bear in mind that banks can be caught in something of a Catch-22, because even being repaid a loan could be illegal.

'Banks,' says Gladstone, 'are really keen to know what their money is going to be used for, and are demanding warranties that loans won't be used to pay anyone that's been listed.' She adds, 'Compliance officers in banks that have been [in trouble over violations] will steer away from making some loans even if they're legal.' Typically, clients are asking how much due diligence they need to undertake, what kind of contractual protections they should have in place, she says. 'These issues can get complicated, and they've got businesses thinking a great deal.'

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Jessica Gladstone, Debevoise

Baker & McKenzie partner Ross Denton points out that it was only toward the middle of December that the UK Export Control Organisation ('ECO') began issuing the licences that the EU had stipulated were required for some exports to Russia in July (clarified in September): 'Even months after the new rules were published, confusion reigned as to how the rules underpinning what could and what couldn't be exported effectively held up legitimate business. The Commission had set out the list using the customs tariff nomenclature but in such a way that it actually made very little sense,' says Denton, adding that while much of the muddle has since subsided, attempts by the Commission to resolve difficulties in interpretation have only been partially successful.

Nor are all questions easily addressed by FAQs. John Grayston of Grayston & Company, says: 'It's clear that if you're in the EU and engaging in business with listed parties, you're subject to sanctions. But what if I'm in Turkey, and I buy goods in the EU and take them to Turkey and sell them from there? Am I then "engaging in business in the EU?" And thus am I subject to EU jurisdiction? Likewise, what if I'm a branch of a UK company in Singapore? Or an individual who's an EU passport holder but I work for a Singaporean company? Am I at risk if I engage in sales activities in breach of EU sanctions? There are "legal" answers to these questions, but the likelihood is that in practice there will be differences in emphasis and approach between national regulators – as ever such difference can easily result in legal uncertainty.'

Taking the penalty

There is, of course, the perennial question as to how violations, egregious or otherwise, will be addressed by the authorities. The dominating narrative is still that U.S. authorities prosecute

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and demand settlement while their EU counterparts, by dint either of lack of resources or political will, take action in only the most egregious cases. One of the lawyers we spoke to for this Focus noted, 'To date there hasn't been a hint of enforcement over the Russia sanctions. But I'd find it hard to believe that no-one's breaking them.'

"Companies are mostly worried about the reputational aspects of doing the wrong deals. So what they're doing is telling the regulators if they're operating in a grey area, and saying, "if you have any problems, let us know."'"

Miriam Gonzalez, Dechert

Another explanation might lie in authorities' lack of willingness to name and shame, for there have been enforcement actions. In 2013, for example, two Germans were fined a total of 350,000 euros for violating the Foreign Trade Act and the Iran Embargo by exporting goods meant for a water reactor in Iran with a licence obtained by giving false information to the German authorities, while in a more recent case, a UK businessman was fined and jailed following an investigation into his export of controlled alloy valves – also to Iran. Yet there has been nothing on the scale of the slew of actions by U.S. regulators, the most high-profile of which have led to multi-million dollar settlements like those with EU banks such as ING, Standard Chartered and BNP Paribas.

Despite this, Benizri strikes a note of caution: 'The EU sanctions measures have to be seen as a regime in their own right. Yes, compliance teams in the United States are of course pushing hard for a U.S. focus – for example, amongst their business partners and subsidiaries. But it's important that people realise that rules are not the same. It's not enough to comply with OFAC rules.'

Miriam Gonzalez, co-chair of Dechert's International Trade and Government Regulation practice, agrees with the oft-made observation that, given very much stronger enforcement activity in the United States, 'There's a culture of fear,' but adds, 'That being said, there's definitely more attention now from EU authorities, more likely to be follow-up after disclosures have been made, and clearly there seems to be more contact between the U.S. authorities and at least some of the EU authorities – like those in Germany, the Netherlands, the UK and France.'

But, as she acknowledges, and in common with the experience of all the trade lawyers spoken to in recent weeks, overwhelmed, under-resourced authorities are currently struggling with all aspects of their workload.

'Companies are mostly worried about the reputational aspects of doing the wrong deals,' says Gonzalez. 'So what they're doing is telling the regulators if they're operating in a grey area, and saying, "if you have any problems, let us know." But it's clear that they just cannot process all the information they receive.'

Lack of capacity and the intrinsically rushed nature of sanctions legislation accounts for many of the criticisms of the way that the 'system' works. As one lawyer put it: 'No-one doubts the need for sanctions, nor begrudges the EU its CSFP, but there's a need for a vastly improved administration to back up the very difficult decisions that are being made. When that goes wrong, we have a massive opportunity to say that things are not being done properly. The question is, are we prepared to have this area of policy operating on a completely different set of standards to other areas. And the answer is "No!"'

Ironically perhaps, some lawyers detect U.S. clients as being more curious about EU restrictive measures than EU companies themselves – for the reason that they are generally more accustomed to sanctions-related issues – while EU companies read frightening cases about enforcement in the United States and make U.S. compliance their focus.

Olivier Prost, a partner in the Brussels office of Gide, observes: 'Many of our clients are more worried about U.S. sanctions first and foremost. But U.S. companies are looking closely at EU sanctions, for example, where they're doing diligence on an EU target, or they have an affiliate and think its activities might expose it to sanctions.'

Matthew Getz, international counsel at Debevoise in London, says that such is the fear of the U.S. regulators that as an EU-based lawyer, he advises his EU clients on EU law first 'but they also want to know the U.S. position even where there is no issue of extra-territorial jurisdiction.'

Popular choice

There is little doubt that, unless policymakers devise some means that falls short of war to achieve their

perceived interests in foreign affairs, sanctions will become increasingly entrenched (in some cases individually, but more generally, as the favoured arrow in the quiver of the Council of the European Union).

It is possible to put the rules 'on track' where they haven't been thought through.

Ross Denton, Baker & McKenzie

Fieldfisher's Laurent Ruessmann believes that the apparent success, thus far, of sanctions in pushing Iran to negotiations over its nuclear weapon programme has 'convinced policymakers on both sides of the Atlantic of the efficacy of sanctions – and that's why they were reached for so quickly in the Ukraine situation. I would have been surprised had that been the response 15 years ago when the use of sanctions was still a relatively rare bird.' (And yet, he adds, both the EU and the U.S. maintain sanctions regimes that achieve little if any positive change, suggesting, 'There should be a thorough annual review, which also takes into account the impact on business.')

With its maturing, so the practice area for lawyers comes to incorporate more strands: a lawyer undertaking sanctions-related work must wear the hats of compliance adviser, political counsellor, potential litigator, and to be prepared to liaise with policy-making institutions on behalf of industry – especially where there's a perceived injustice in the regulations. Indeed, says Baker & McKenzie partner Ross Denton, it is possible to put the rules 'on track' where they haven't been thought through: 'Last year, we were advising an association of oil and gas producers on an ISO standard that it was developing to increase safety in the oil industry. The issue that arose was that, the way both the EU and U.S. sanctions were written would have made it unlawful for members of that association to share the standard with Iran or have an Iranian involved in the procedure – because although there were exemptions for technology, there weren't any for technical assistance. The Commission and some national agencies have accepted that the rules appear to cover international standards in a way that is unintended. Unfortunately, resolving the issue is harder than identifying the problem.'

Challenging times

While many firms are advising clients on internal compliance procedures, internal investigations, and whether or not to make disclosures, there's an area of practice that is quite possibly more active in the EU than it is in the U.S. – and that is the challenging of designations. Recent years have seen a rise in the number of cases where the EU General Court in Luxembourg has annulled the listings of, in particular, Iranian banks (such as Bank Mellat and Bank Saderat), often finding that the Commission had failed to provide sufficient evidence to stand the rigour

of scrutiny. Typically, those victories are pyrrhic, the plaintiffs remaining reputationally-damaged, and often re-listed on new grounds.

Last year's extension of this phenomenon was the lodging of a number of challenges by companies and banks subject to the EU Russia sanctions – amongst them, Rosneft and Gazprom Neft – though where the Iranian banks sought to annul their listings, the Russian applicants have sought to annul key elements of the restrictive measures. These include prohibitions on the provision of 'technical assistance, brokering services or other services related to goods and technology set out in paragraph 1 and to the provision, manufacture, maintenance and use of these goods and technology, directly or indirectly to any person, entity or body in, or for use in Russia,' and the ban on exports of technologies destined for deep water oil and Arctic oil exploration and production or shale oil projects in Russia.

There is some scepticism as to the value of such suits given that the measures are expressions of political will and thus not easily reversed by legal argument (Dechert's Miriam Gonzalez suggests that suits by designated parties 'have become pro forma'). But perhaps the next growth industry lies not in taking on the Commission, but in the myriad of disputes generated by disruption to business relations.

Chris Caulfield of the London office of Baker & Botts undertakes substantial volumes of work for oilfield servicing companies, typically registered 'in the UK, U.S., BVI or Netherlands', and exporting goods and services to Russia. He says, the office is busy 'doing a lot of work on issues such as *force majeure* and frustration. In fact, it's unprecedented in terms of volume.' And, he says, because the firm also has an office in Moscow they see, 'both sides of the story – there are some very complex issues at play.'

Latham's Charles Claypoole returns the same observation: 'We've just been contacted by a foreign subsidiary of a British company that needs to know the consequences of pulling out of a deal with a Russian partner. What's interesting in this scenario is the way that the legal regimes clash, the tension between the regulatory requirements and the contractual requirement, and added to that, the layering of national laws. We've seen the situation, for example, where an EU affiliate is reluctant to do something because it's afraid of what OFAC will do, but is obliged to proceed under the law of, for example, a EU Member State.'

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Chris Caulfield, Baker Botts

It looks likely that such multi-jurisdictional, quasi-political, quasi-legal questions will continue to tax the over-burdened minds of Europe's sanctions lawyers for some time to come. On 19 January, the EU Council on Foreign Affairs announced that there would only be a let-up in its pressure on Russia 'if and when the Minsk commitments are implemented' – but, said Federica Mogherini, until then, there will be no change in 'relations'.

And as one of the lawyers we spoke to says he likes to observe, 'The trend seems to be is that sanctions have a long tail. And even as one situation is subsiding, another is brewing. It's good for practice – though of course, not for global commerce.'

Indeed, if the issue of Russia has pushed Iran out of the limelight, that's not to say, believes Konstantinos Adamantopoulos, that EU businesses have forgotten the existence of what was until recently an important if specialist market: 'Everyone wants to know what's going on. A lot of people are hopeful that these negotiations are going to yield results. I think the industry view is that we're approaching the end of the sanctions regime, and that we're at the stage of not if, but when,' he says. 'What the Russia experience has shown us is that sanctions can now take so many forms, that many different tools can be created to suit different purposes and objectives. EU businesses now know that they're always going to be having to factor them into their activities.'

Merchants in fish, figs and pigs, Aristophanes would be little surprised to discover, will continue to find cause to moan.