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Export Controls Alert

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What the new US embargo against the breakaway regions in Ukraine means for exporters

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President Biden's executive order is effective immediately and prohibits virtually all direct and indirect transactions with the breakaway Ukrainian regions of Donetsk and Luhanks. The White House has signaled that wider sanctions will be imposed "should Russia further invade Ukraine."

What's the Impact?

- The executive order imposing a *de facto* embargo on both regions mirrors the US's approach to Crimea
- US exporters must comply with these restrictions, and foreign entities and individuals should also be aware of the prohibited transactions
- Companies doing business in the region should expect wider sanctions if the situation continues to escalate

Last night, the US president signed a new executive order that essentially imposes a US embargo on the breakaway Donetsk People's Republic (DNR) and Luhansk People's Republic (LNR) regions of Ukraine, and any other regions of Ukraine as may be determined by the Secretary of

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the Treasury, in consultation with the Secretary of State. The restrictions are effective immediately. The new executive order prohibits virtually all direct and indirect transactions (including financial, trade, and other commercial transactions) by US persons or within the United States to or from these regions unless authorized by OFAC or exempted by statute. However, foreign entities and individuals should also take note of these restrictions, as explained below.

The executive order refers to the affected regions in Ukraine as the "Covered Regions." At this point, only the DNR and LNR are affected. However, additional regions of Ukraine could be swiftly added should Russian troops enter other regions of Ukraine. The US government could add additional regions, for example, through the issuance of a directive that would be effective as soon as it was issued.

The new embargo mirrors the US embargo against the Crimea region almost verbatim. The Crimea embargo was imposed on December 19, 2014, through Executive Order 13685. A word comparison of the Crimea embargo against the new executive orders shows that the restrictions are essentially the same. As is the case with Crimea, a difficulty for complying with this executive order will be that the Covered Regions are not a country. Country-based identifiers, such as country-based IP addresses and SWIFT codes, do not flag these regions (compared to embargoed countries, such as Iran). We address this compliance issue in more detail below.

The new executive order includes primary sanctions provisions directed at US persons, as well as a secondary sanctions provision directed at anyone that materially assists or provides financial, material, or technological support for, or goods or services to or in support of, any person whose property and interests in property are blocked pursuant to this new executive order.

Specifically, the new executive order (which has not yet been numbered) prohibits:

- the *exportation*, *reexportation*, *sale*, or *supply*, directly or *indirectly*, from the United States, or by a United States person, wherever located, of *any* goods, services, or technology to the Covered Regions;
- any approval, financing, *facilitation*, or guarantee by a United States person, wherever located, of a transaction by a foreign person where the transaction by that foreign person would be prohibited by this section if performed by a United States person or within the United States;
- new investment in the Covered Regions by a United States person, wherever located; and
- the importation into the United States, directly or indirectly, of any goods, services, or technology from the Covered Regions.

The first two restrictions are the key ones for US exporters. Even though at first glance most US exporters may not directly export to the DNR and LNR, given that both regions have been affected by armed conflict for several years, US exporters will need to make sure that their products, software, and technology do not reach the Covered Regions through others, e.g., foreign subsidiaries, distributors, or other intermediaries. The exportation clause is broadly

phrased and includes reexportation, whether directly or indirectly (through others). Diversion to the Covered Regions can be expected to occur through intermediaries in Russia and Belarus, as well as Ukraine. Companies whose products are exported or reaexported to Ukraine, Russia, or Belarus should update their export documentation, including contractual clauses and end use certifications to include the Covered Regions into their embargoed destinations provisions (similarly to how Crimea was added when the embargo was imposed). The wording used should also provide flexibility should other regions of Ukraine be sanctioned. Exporters should also expect the U.S. Department of Commerce's Bureau of Industry and Security (BIS) to issue parallel restrictions under Part 746 of the Export Administration Regulations (EAR), as it did for Crimea under Section 746.6 of the EAR. Specifically, these restrictions would then prohibit the export, reexport, or in-country transfer of all items that are subject to the EAR to the Covered Regions. BIS will likely exempt the same products as for Crimea from these restrictions, specifically food and medicine designated as EAR99 or software that is necessary to enable the exchange of personal communications over the Internet, provided that such software is designated EAR99 or is classified as mass market software under Export Control Classification Number (ECCN) 5D992.c of the EAR, and provided further that such software is widely available to the public at no cost to the user.

The prohibited "facilitation" clause under subsection (b) above is also problematic. The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) has used the term "facilitation" for years to rope US companies and other US persons into potential enforcement actions. For example, a transaction involving the Covered Regions that may, on its face, not have a US nexus (no US-origin product, no US parties) could trigger primary sanctions if a US affiliate, anyone located in the US, or a US person employee abroad was involved in the transaction.

Foreign companies should keep the US charging theory of "causing a violation" by a US person in mind under the International Emergency Economic Powers Act (IEEPA). The new executive order was issued under IEEPA. OFAC continues to penalize foreign entities and individuals under its charging theory of "causing a violation" by a US person. This is a classic sanctions issue when foreign entities, for example, transact with a sanctioned party or region and the transaction in and by itself would not trigger a sanctions violation, but the parties introduce a US nexus, such as a US dollar-denominated payment, which OFAC generally views as involving a U. financial institution and foreign branch. That transaction would then cause the violation of the US sanctions by that US financial institution and foreign branch, regardless of whether or not the US party involved was aware of the sanctions issue. A review of OFAC's published enforcement cases from 2021 shows that this charging theory continues to be a relevant sanctions enforcement tool.

As in the Crimea embargo, the prohibitions include (a) the making of any contribution or provision of funds, goods, or services by, to, or for the benefit of any person whose property and interests in property are blocked pursuant to this order; and (b) the receipt of any contribution or provision of funds, goods, or services from any such person.

The new executive order also provides a wide legal authority to sanction anyone whom the Secretary of the Treasury, in consultation with the Secretary of State, determines:

- to operate or have operated since February 21, 2022, in the Covered Regions;
- to be or have been since February 21, 2022, a leader, official, senior executive officer, or member of the board of directors of an entity operating in the Covered Regions;
- to be owned or controlled by, or to have acted or purported to act for or on behalf of, directly or indirectly, any person whose property and interests in property are blocked pursuant to the new executive order; or
- to have materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of, any person whose property and interests in property are blocked pursuant to the new executive order.

In practice, the Secretary of the Treasury generally delegates its authority to OFAC, which in turn implements these targeted sanctions by designating entities and individuals on the Specially Designated Nationals and Blocked Persons (SDN) List, which OFAC (in consultation with the State Department) determines meet any of these criteria. From a sanctions compliance perspective, US companies should ensure that they use sanctions screening tools that are automatically updated and flag any new names that are added to the SDN list under this executive order. Further, companies should also ensure that they conduct ownership due diligence regarding entities in the region to ensure that contracting parties are not owned, directly or indirectly, individually or collectively 50% or more by anyone on the SDN list. It should be noted that the above sanctions authority goes beyond ownership and also includes control. However, that is relevant with respect to who could be added to the SDN list; it (thus far) does not alter OFAC's aggregate 50% rule.

Foreign companies should take note of the "materially assist" clause in the last bullet point above. It includes OFAC's typical secondary sanctions language from similar executive orders, which allows OFAC to designate foreign parties on the SDN list—regardless of any US nexus whatsoever—if they "materially" assist or provide financial, material, or technological support for, or goods or services to or in support of, any person who has been designated on the SDN list pursuant to this new Executive Order (or an entity that falls under the SDN restriction pursuant to OFAC's aggregate 50% rule).

As noted above, a compliance issue will be that the Covered Regions are not countries. Country-based identifiers, such as country-based IP addresses and SWIFT codes, will not flag these regions (compared to embargoed countries, such as Iran). Exporters have had to deal with this difficulty in the Crimea context. There have been OFAC enforcement cases on the issue of faulty compliance screening that did not detect Crimea-related transactions. In the Crimea context, entities in the region have attempted to circumvent or evade US sanctions involving Crimea since the embargo was first implemented in 2014. Companies and individuals conducting business in or through the United States should be aware of these practices in order to implement appropriate controls, commensurate with their OFAC sanctions risk profile, to ensure compliance with their OFAC obligations. For example, some business partners in the region omit or obfuscate references to the Covered Regions and locations within these regions. In the context of financial transactions, individuals or entities may omit originator or beneficiary address

information from SWIFT messages involving individuals ordinarily resident in, or entities located in, these regions. This has been an issue in the Crimea context. Further, while the United States does not recognize the legitimacy of Russia's recognition of the Covered Regions as "independent" regions (which may be annexed by Russia, as Crimea), business partners could list counterparties on financial and trade documents as being located in Russia rather than in Ukraine. For example, a US company may have executed a distribution agreement with a third-country company that authorizes the distributor to sell US products to Russia. The third-country distributor may be unaware that the United States does not recognize these regions as "independent" or, as it will likely happen, as a part of Russia or may intentionally exploit any confusion over this fact in order to sell the US company's products to individuals or entities in the Covered Regions. This risk could be mitigated by, for example, ensuring that transaction monitoring systems include appropriate search terms corresponding to major geographic locations in the Covered Regions (such as cities) and not simply references to "Donetsk" or "Luhansk." Companies should consider requesting additional information from parties through end use(r) certifications, and clearly communicating US sanctions obligations to international partners, especially in Ukraine, Russia, and Belarus.

Finally, OFAC has issued six general licenses, specifically:

- Ukraine General License Number 17—Authorizing the Wind Down of Transactions Involving the So-called Donetsk People's Republic or Luhansk People's Republic Regions of Ukraine
- Ukraine General License Number 18—Authorizing the Exportation or Reexportation of Agricultural Commodities, Medicine, Medical Devices, Replacement Parts and Components, or Software Updates to Certain Regions of Ukraine and Transactions Related to the Coronavirus Disease 2019 (COVID-19) Pandemic
- Ukraine General License Number 19—Authorizing Transactions Related to Telecommunications and Mail
- Ukraine General License Number 20—Official Business of Certain International Organizations and Entities
- Ukraine General License Number 21—Authorizing Noncommercial, Personal Remittances, and the Operation of Accounts
- Ukraine General License Number 22—Authorizing the Exportation of Certain Services and Software Incident to Internet-Based Communications

Anyone intending to use any of these general licenses should ensure that the activity is truly covered under the wording of the respective general license. OFAC tends to read and interpret the wording in general licenses narrowly. General License Number 17 allows a wind-down period for pending transactions until March 23, 2022, as long as the transaction does not involve entities or individuals that have been designated under this executive order on the SDN list (or that are subject to the SDN restrictions through OFAC's aggregate 50% rule).

General License Number 18 could be of interest for exporters of agricultural commodities (food), medicine, and basic medical devices. General License Number 22 authorizes some exports involving services and software incident to internet-based communications.

Companies doing business in the region should expect additional sanctions, if the situation continues to escalate. The US government has various sanctions tools at its disposal. There has been various chatter about what could be imposed, such as severe financial sanctions against Russian banks, additional export control restrictions, blocking Russia from access to the US dollar-denominated transactions, cutting Russia out of the SWIFT financial system, and a full trade embargo. For the time being, exporters should certainly expect OFAC to use this new executive order to sanction additional entities and individuals and to potentially add other regions of Ukraine to the embargo restrictions of this executive order should Russian troops enter other regions. Such measures could certainly also hurt Ukraine, particularly if more of its territory becomes subject to the new embargo. However, what exactly the next round of sanctions will entail is highly dependent on how the geo-political situation develops.

We will provide further updates and analysis as the situation continues to evolve.

If you have any questions about the new executive order or other US sanctions, please contact your Nixon Peabody attorney or:

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