

After Washington Drama, New Russia (and Iran and N. Korea) Sanctions Set to Become Law

26 July 2017

On Tuesday, July 25, the U.S. House of Representatives passed H.R. 3364, the Countering America's Adversaries through Sanctions Act by a vote of 419-3. There is some uncertainty, but the legislation is expected to be passed by the Senate before the August recess and sent to the President for his signature. The House voted to amend a bill containing an Iran and Russia sanctions package that passed the Senate on June 15 a vote of 98-2 (see our June 20 [client alert](#) explaining the key provisions of S.722 when it passed the Senate). Much of our original analysis of the Russia sanctions measures remains in effect. This latest client alert details the key changes to the Russia sanctions made under a bipartisan agreement, and explains the addition of North Korea sanctions to the same legislation.

After the passage of the Senate bill, the White House, U.S. energy companies, and European governments advocated against a number of key provisions pertaining to the Russia sanctions. Last weekend, a group of House and Senate leaders reached the aforementioned bipartisan agreement, making changes to certain Russia-related sanctions provisions, leaving the Iran sanctions unchanged, and adding sanctions against North Korea. Notably, the lawmakers did not accede to the White House's sought-after changes to the bill's restrictions on the President's ability to lift sanctions against Russia without first seeking congressional approval. If enacted, this bill represents both a sanctions escalation against Russia and a break from what had been a unified U.S.-EU approach to Russia sanctions under the Obama Administration.

Key Russia-Related Changes to H.R. 3364

Sanctions on Financial Services and Energy Sectors

1. As with the original bill, H.R. 3364 would codify and expand existing sanctions against the financial and energy sectors in Russia. This includes requiring the Department of Treasury to modify Directives 1 and 2 to make transactions that have a U.S. nexus and that involve new "debt" of certain designated Russian financial institutions and energy companies on the Sectoral Sanctions Identification List (SSIL) more difficult by reducing the length of the maturity date for debt financing (or other extension of credit) from 30 to 14 days. H.R. 3364 reduced the length of the maturity date for debt financing (or other extension of credit) for designated Russian energy firms from 90 to 60 days. As such, U.S. persons will be restricted from processing, or otherwise participating in, a wider range of transactions involving Russian banks and energy companies designated on the SSIL under these directives (as with existing sectoral sanctions, these restrictions extend to any entity in which a designated party on the SSIL holds, directly or indirectly, an equity interest of 50 percent or more).

2. As with the original bill, H.R. 3364 also would expand Directive 4 to prohibit U.S. persons from providing any goods, services (except for financial services), or technology in support of exploration or production for deepwater, Arctic offshore, or shale projects involving a designated Russian energy company, regardless of the location of the project. The Senate bill did not specify the percentage of Russian control over, or interest in, such a project that would have triggered the application of this provision. The House bill sets the percentage of a controlling interest or a substantial non-controlling ownership in one of these projects at 33 percent, which effectively narrows the scope of restrictions from the Senate version. Previously, any project with even a small interest held by a designated Russian party could have triggered Directive 4 restrictions.

In the past, Directive 4 was focused on those projects within Russia or Russian waters. Now, such projects outside of Russia would also be prohibited if a Russian-designated party or its interests are involved, and the Russian party has at least a 33 percent interest in such project. For example, Directive 4 would now apply to a Russian-designated energy company engaging in a deepwater exploration project off the coast of Iraq or Venezuela if such Russian party also has at least a 33 percent interest in that project.

Sanctions on the Russian Intelligence and Defense Sectors

As with the original bill, H.R. 3364 would *require* the President to impose sanctions on persons that he or she determines knowingly engage in a “significant” transaction with a person that is part of, or operates for or on behalf of, the defense or intelligence sectors of the Government of the Russian Federation, including the Main Intelligence Agency of the General Staff of the Armed Forces of the Russian Federation or the Federal Security Service of the Russian Federation. The Senate bill did not require the President to identify parties in Russia that are targeted by this section. To clarify this ambiguity in light of the broad language otherwise used in this provision (i.e., a person who is “a part of” or “operates for” these sectors), the House bill instructs the President to issue “regulations or other guidance to specify the persons that are part of, or operate for or on behalf of, the defense and intelligence sectors of the Government of the Russian Federation.”

This list should provide greater clarity as to who is targeted by this provision. Those parties identified on the list will find it increasingly difficult to engage in transactions with any persons (U.S. or non-U.S.), as significant transactions with listed parties would create exposure under this provision that has extra-territorial reach and does not require U.S. nexus. For example, banks may be reluctant to provide financing to Russian parties identified on this new list as being part of the defense sector for purposes of section 231, as such transactions could create exposure for the banks themselves under this extraterritorial provision, even if the activity has no U.S. nexus. The House bill also permits the President to delay the imposition of sanctions on persons under this section if they are “reducing the number of significant transactions” with the Russian intelligence or defense sectors. This is an important flexibility that allows the U.S. administration to accept a reasonable wind-down period by companies that need time to extricate themselves from existing relationships with parties that become added to the new list. In addition, there is a presidential waiver provided for in this section.

Sanctions With Respect to the Development of Energy Export Pipelines in the Russian Federation

The Senate bill authorized the President to impose sanctions on a person who has (1) been determined to knowingly make an investment that directly and significantly contributes to the enhancement of the Russian Federation’s ability to construct energy export pipelines, or (2) sells, leases, or provides to the Russian Federation, for the construction of Russian energy export pipelines, goods, services, technology, information, or support (any of which has a fair market value of US\$1 million or more, or

that, during a 12-month period, has an aggregate fair market value of US\$5 million or more) that could directly and significantly facilitate the maintenance or expansion of the construction, modernization, or repair of energy pipelines by the Russian Federation. The House bill adds that the President's decision to impose sanctions should be taken "in coordination" with U.S. allies. This should provide significant flexibility to the Trump administration. However, questions remain as to whether certain existing or planned pipeline projects in Europe will be impacted by this new provision, or, conversely, whether the Trump administration will, in coordination with U.S. allies such as Germany and Austria, decide not to use these authorities against pipelines that bring Russian gas to Europe.

#####

North Korea-Related Sanctions

Finally, H.R. 3364 also contains a package of sanctions against North Korea, closely tracking H.R. 1644, the Korea Interdiction and Modernization of Sanctions Act, which passed the House on May 4, 2017 by a vote of 419-1. This section of the legislation amends the North Korea Sanctions and Policy Enhancement Act of 2016 to modify and increase the President's authority to impose sanctions on persons in violation of certain U.N. Security Council resolutions regarding North Korea. The sanctions are aimed at denying hard currency to the North Korean regime.

The legislation builds on the U.S. Treasury's Financial Crimes Enforcement Network's 2016 finding that North Korea is a jurisdiction of primary money laundering concern and imposition of due diligence requirements on covered financial institutions to prevent processing transactions on behalf of North Korean financial institutions through indirect correspondent accounts. In particular, U.S. financial institutions are required to ensure that no correspondent accounts are being used by foreign financial institutions to provide financial services indirectly to North Korea. As we have previously [suggested](#), financial institutions that have relationships with Chinese banks should review their due diligence policies. The President is also required to impose U.S. property-based sanctions on foreign persons that employ North Korean forced laborers.

We note that the U.S. government already maintains a very broad set of sanctions against North Korea that prohibit virtually all activities that have a U.S. nexus, with some limited exceptions. We further note that the U.S. State Department is expected to publish a notice this week in the Federal Register that will announce, with an effective date 30 days after publication, a ban on the use of U.S. passports for travel to/from North Korea.

#####

We will continue to monitor this space closely and report on the implications for U.S. sanctions and export control laws.

Special thanks to Lisa Ann Johnson, a summer associate in our Washington, D.C. office, for her contribution to this post.

Contacts



Aleksandar Dukic

Partner, Washington, D.C.
Tel +1 703 587 8145
aleksandar.dukic@hoganlovells.com



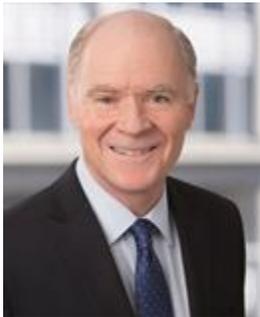
Andrew Keller

Partner, Washington, D.C.
Tel +1 202 637 5649
andrew.keller@hoganlovells.com



Ajay Kuntamukkala

Partner, Washington, D.C.
Tel +1 202 637 5552
ajay.kuntamukkala@hoganlovells.com



Robert Kyle

Partner, Washington, D.C.
Tel +1 202 637 5494
robert.kyle@hoganlovells.com



Beth Peters

Partner, Washington, D.C.
Tel +1 202 637 5837
beth.peters@hoganlovells.com



Adam Berry

Associate, Washington, D.C.
Tel +1 202 637 2871
adam.berry@hoganlovells.com



Ari Fridman

Associate, Washington, D.C.
Tel +1 202 637 5449
ari.fridman@hoganlovells.com