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The Ukraine Crisis: Sanctions Scenarios in the Event of Russian Invasion

By Tom Best, Mary Rogers & Samuel Pickett

As the security crisis involving Ukraine, the Russian Federation, and the West continues to escalate, the U.S., EU, U.K., and other Western governments have been working to agree on a package of economic sanctions that would inflict sufficient pain on the Russian economy so as to deter a Russian invasion up front. Media outlets are reporting that the measures under consideration by the U.S. Administration would be of the most far-reaching scope and scale ever against a major economy such as that of Russia.[1] Reports are also that the level of coordination between Western jurisdictions to achieve a common set of measures across North America, Europe, the U.K., and others to be imposed on Russian interests continues to be unprecedented.[2] No government, however, has definitively announced the measures that will be taken in the event of an invasion of Ukraine, or in the event that Russian or Russian-controlled forces[3] make a more "minor incursion"[4] into Ukrainian territory or against Ukrainian interests. As a result, companies and financial institutions have been left to speculate on what types of sanctions may or may not be likely—posing business planning and compliance challenges as the situation on the ground rapidly evolves.

As we describe below, public pronouncements by U.S., U.K., and EU government officials, and pending bills in the U.S. Congress, provide at least some idea as to the likely measures that may be adopted. Different scenarios range from relatively minor blocking measures targeted at specific members of Russian President Putin's inner circle in a limited-incursion scenario, all the way to prohibiting the Russian financial sector from participating in the international banking system.

Foreign Policy Considerations

Economic sanctions are used by countries around the world to advance their foreign policy goals. Sanctions—and the threat of sanctions to deter an invasion of Ukraine—against the Russian Federation are no exception. The last major set of sanctions imposed against Russia came in the face of its annexation of Crimea in 2014. Those sanctions targeted individuals who had undermined Ukraine's security, stability, sovereignty, or territorial integrity, through their affiliation with efforts to create breakaway regions in Eastern Ukraine, the annexation of Crimea, or both.[5] Sectoral sanctions, cutting off access to most Western capital markets, were applied to specific entities in Russia's financial, energy, and defense sectors.[6]

Western leaders—including President Biden in a February 15 news conference—have stated that in the face of a full-scale invasion of Ukraine they are prepared to impose an "unprecedented package" of sanctions on Russia, the likes of which have never been imposed on a major economy.[7] That said, some

NATO members' interests are not perfectly aligned, which has appeared to make negotiation of a common sanctions package among the EU (principally France and Germany), U.S., U.K., and others a relatively difficult and time-consuming process. Germany in particular depends on the Russian Federation for over one-half of its natural gas needs—a critical source of energy as Germany moves away from nuclear power plants—and has appeared reticent to include the Nord Stream 2 pipeline in any sanctions package.[8] The U.S. and the U.K., on the other hand, have advocated for the most stringent sanctions, with debate in the U.S. Senate between Democrats and Republicans centered in part on whether to impose targeted sanctions on the Nord Stream 2 pipeline immediately,[9] or whether sanctions on Nord Stream 2 should be part of a much broader sanctions response enacted only after a Russian invasion.[10] For its part, the U.K. government recently introduced a bill providing it the authority to sanction any individual or entity which has been involved in obtaining a benefit from, or supporting, the Government of Russia—allowing the U.K. to sanction the significant number of oligarchs, regime insiders, and their family members with significant presence or assets in Britain.

Likely Responses to A Russian Invasion

As of the afternoon of February 15, media outlets are reporting that the material terms of a sanctions package had been agreed between the U.S., EU, U.K., and Canada, and that the U.S. Congress had been unable to agree to additional measures which Senate Democrats and Republicans had been negotiating for weeks. In light of the Senate's inability to agree to additional measures, the ranking Republican on the Senate Foreign Relations Committee, Jim Risch (R-Idaho), introduced his own bill which reportedly reflected many of the measures the Biden Administration had agreed on with the EU, U.K., and Canada, but which also went further than the Administration's current plans and the measures Democrats and Republicans had agreed on in the Senate.[11]

Nevertheless, many elements of that bill likely reflect the sanctions package the Administration has agreed on with U.S. allies, even if some of the more extreme elements would not be enacted:

- Designation as Specially Designated Nationals ("SDN"), and revocation of the U.S. visas of so-called Russian "oligarchs," including members of Russian President Putin's inner circle, their close family members, and even President Putin himself in his personal capacity, and freezing of their assets across the West. These measures would be intended to ensure that the Russian elite—on whom the Russian President depends for political support—would be unable to travel to or access any of their assets in the U.S., U.K., EU, or Canada, where many of them maintain significant ties.

- Designation as SDNs of Russian state-owned banks VTB, VEB.RF, the Russian Investment Fund (the Sovereign Wealth Fund of the Russian Federation) and Alfa Bank, and the designation as SDNs or prohibition on providing U.S. dollar clearing services to at least eight other Russian banks, including Gazprombank, Sberbank, Credit Bank of Moscow, Rosselkhozbank, FC Bank Otkritie, Promsvyazbank, Sovcombank, Transkapitalbank, or "any other comparable Russian financial institution as determined by the President."[12] While we would expect these measures to be accompanied by a number of General Licenses implementing wind-down periods, humanitarian exceptions and other carve-outs in order to mitigate the most acute collateral consequences, we also would expect the U.K., Canada, EU, and others to enact parallel restrictions making hard currency transactions (i.e., in Euros, Canadian Dollars, U.K. pounds, and other currencies) extremely difficult for Russian banks to execute. Russian banks—and, therefore much of the wider Russian economy—would thus lose their ability to participate in the global economy.

- Designating as SDNs a significant portion of the Russian oil and gas, metals and mining, and other extractive industries. As the Russian Federation's primary hard currency-earners and the major drivers of Russia's economy, severe sanctions against the Russian extractive industry would cut off a vital hard currency lifeline for the Russian regime, and also act as a severe blow to the Russian economy.

- Also included in the Risch bill (and a parallel Democratic bill introduced by Senate Foreign Relations Committee Chairman Robert Menendez (D-NJ), which reportedly reflected the Biden Administration's key desires for their Russian sanctions package at the time) are sanctions prohibiting U.S. persons from dealing in sovereign debt of the Russian Federation issued on or after the date sanctions were enacted, and prohibitions on dealing in the debt of at least ten Russian state-owned enterprises to be named at a later date by the Administration. These restrictions would be in addition to the existing U.S. sectoral sanctions prohibiting U.S. persons from dealing in new debt (with the exception of some very short tenor issuances) of Sectoral Sanctions Identifications ("SSI") Directive 1-designated Russian financial institutions and SSI Directive 2-listed energy and extractive companies.[13]

- While the German government and EU authorities have not commented to date directly on their approach to the Nord Stream 2 pipeline project—a sensitive point for the Germany economy due to that country's dependence on Russian natural gas imports for much of its energy supply, the Biden Administration has been clear that in the event of a Russian invasion of Ukraine, "there will no longer be a Nord Stream 2. . . . We will bring an end to it." Given President Biden's reiteration of that position, using forceful language, in his afternoon address to the nation on February 15, we expect that the U.S. would follow through on this position, even in the face of significant German resistance.

And, interestingly, recent press reports have indicated that the final package of coordinated sanctions agreed among the U.S., U.K., EU, and Canada does not currently include prohibiting Russia and Russian financial institutions from participating in SWIFT and other financial messaging services. Nor does the Risch bill include provisions that would prohibit foreign exchange transactions with Russian counterparties.[14] While these may seem like significant omissions, the disruption to the Russian economy of a coordinated designation by U.S., EU, U.K., and Canada of a majority of the major Russian financial institutions as SDNs (or their equivalents) would likely have much of the same effect.

Last, the Administration has been clear that it will seek to impose strict export controls on Russian industry, in order to deny the country access to technologies critical to a modern economy. These export controls very likely would come in the form of the Foreign Direct Product Rule ("FDPR"), which allows the U.S. Department of Commerce Bureau of Industry and Security ("BIS," the U.S. agency primarily responsible for U.S. export controls) to extend its reach to regulate goods being exported, reexported, and transferred if (i) they contain certain U.S. controlled technology and software; or (ii) they are produced from plants, or with major components of plants, that are themselves derived from U.S. controlled technology and software. In this way, a whole host of items normally outside the reach of the Export Administration Regulations ("EAR") are captured.

Notably, the FDPR was instrumental in severely curtailing dominance of China-related companies, as it hampered their ability to procure semiconductor chips—an integral component in its devices. At this juncture, it is unclear what exact impact the FDRP would have on Russia's economy, but if the Chinese example is any indication, the impact would not be felt lightly.

What Companies And Institutions Can do To Prepare

The specific package of measures that the West would impose on the Russian economy likely depends on the precise character of any invasion of Ukraine that prompts the actions. That said, it is clear from the above that the U.S., U.K., EU, and other Western governments are prepared to impose the most far-reaching set of economic restrictions ever attempted outside of the U.S. embargoes of Cuba, North Korea, and Iran, on a coordinated basis.

As the situation evolves, companies and financial institutions with Russian business would be well-served to conduct an enterprise-wide assessment of their exposures to Russia if they have not done so already, in order to gauge the likelihood of these potential sanctions impacting their business. Those assessments should not only take into account the direct compliance risk of measures likely to be enacted should Russian invade Ukraine, but also their effects on companies' and institutions' business counterparties in Russia and globally, and their ability to operate successfully.

For example, the U.S. Treasury's Office of Foreign Assets Control ("OFAC"), the administrative agency responsible for development and implementation of most U.S. sanctions programs, was subject to criticism in 2018 for their sanctioning of a Russian oligarch and his interests in the global aluminum industry, which in turn caused price spikes and shortages of a critical commodity at the time. With the potential for Russian oil and gas, metals and mining, financial services, and other key industries all to come under severe U.S., U.K., EU, Canadian, and other sanctions in the days or weeks to come, companies with even indirect exposure to Russia would be well-served to plan in advance for potential business disruptions, in addition to measures they may be forced to take to maintain their own legal compliance.

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We at Paul Hastings are continuing to monitor developments in Ukraine and Russia closely and will update this post as there are material developments. In the meantime, please feel free to reach out to any of the following Paul Hastings Washington, D.C. lawyers:

Tom Best
1.202.551.1821
tombest@paulhastings.com

Mary E. Rogers
1.202.551.1833
maryrogers@paulhastings.com

Samuel H. Pickett
1.202.551.1944
samuelpickett@paulhastings.com

[1] Alan Rappeport, *U.S. Allies' Sanctions Could Cut Russia Off From Message System*, N.Y. Times, Feb. 1, 2022, at B3; *America prepares the "mother of all sanctions" against Russia*, The Economist (Feb. 5, 2022), https://www.economist.com/finance-and-economics/america-prepares-the-mother-of-all-sanctions-against-russia/21807487 (President Biden said that President Putin has "never seen sanctions like the ones I promised will be imposed").

[2] *U.K. Readies Extra 1,000 Troops to Support NATO: Ukraine Update*, Bloomberg (Feb. 9, 2022), https://www.bloomberg.com/news/articles/2022-02-09/congress-split-on-sanctions-while-eu-keeps-quiet-ukraine-update (stating that the "U.K. is putting more troops on standby to bolster a humanitarian response in the event of a conflict" and that "the EU's foreign policy chief Josep Borrell will respond on behalf of the bloc" in a response "closely coordinated" with NATO); *see also* Nathalie Tocci, *Europe is ready to pay the cost of Russia sanctions*, Politico (Feb. 2, 2022), https://www.politico.eu/article/europe-energy-russia-ukraine-crisis-eu-gas-prices/ (claiming that "[f]or the most part, Europe is remarkably united on Russia" and that the "European Union, the United States, and the United Kingdom would also agree that the primary response to Russian aggression is sanctions").

[3] Russia reportedly is conducting military exercises with Belarussian forces in Belarus.Western officials have stated that should Belarus join Russia in an invasion of Ukraine, Belarus itself would be subject to additional economic sanctions.Robbie Gramer and Amy Mackinnon, *Western Officials Warn Russia's Troops in Belarus Could be Permanent*, Foreign Pol'y (Feb. 8, 2022), https://foreignpolicy.com/2022/02/08/belarus-russia-troop-buildup-could-be-permanent-ukraine-crisis/.

[4] Asma Khalid, *How Biden is trying to clean up his comments about Russia and Ukraine*, NPR (Jan. 20, 2022), https://www.npr.org/2022/01/20/1074466148/biden-russia-ukraine-minor-incursion (referencing President Biden's comments that "I think what you're going to see is that Russia will be held accountable if it invades. And it depends on what it does. It's one thing if it's a minor incursion and then we end up having a fight about what to do and not do.").

[5] Cong. Rsch. Serv., IF10779, U.S. Sanctions on Russia: An Overview (2021).

[6] *Id*.

[7] Daniel Boffey, *U.K. warns of 'unprecedented sanctions' against Russia as Biden says west is united on Ukraine*, The Guardian (Jan. 24, 2022), https://www.theguardian.com/world/2022/jan/25/us-uk-and-europe-totally-united-in-the-face-of-russia-threat-to-ukraine-biden-says.

[8] Jennifer Rankin, *What have Nord Stream 2 and gas got to do with the Ukraine standoff*, The Guardian (Feb. 7, 2022), https://www.theguardian.com/world/2022/feb/07/what-have-nord-stream-2-and-gas-got-to-do-with-ukraine-standoff (stating that the U.S. has insisted that the pipeline will not move forward if Russia invades Ukraine, but that "[s]omewhat less emphatically, Germany's foreign minister, Annalena Baerbock, has said the pipeline would be up for discussion as part of sanctions measures"); Melissa Eddy, *Germany Tries to Loosen Its Ties to Russian Gas Pipelines*, N.Y. Times (Feb. 14, 2022), https://www.nytimes.com/2022/02/14/world/europe/germany-energy-russia-gas-pipeline.html (Describing German Chancellor Olaf Scholz as having "not yet been as forthcoming about preventing" the Nord Stream 2 from happening).

[9] Deterring Authoritarian Hostilities Act, S.3513, 117th Cong., 2nd Session (2022), available at: https://www.congress.gov/bill/117th-congress/senate-bill/3513/text?r=1&s=1.

[10] Defending Ukraine Sovereignty Act of 2022, S. 3488, 117th Cong., 2nd Session (2022), available at: https://www.congress.gov/bill/117th-congress/senate-bill/3488/text?r=2&s=2.

[11] Andrew Desiderio, *Senate to settle for symbolic rebuke as Russia sanctions talks fizzle*, Politico (Feb. 15, 2022),

https://www.politico.com/news/2022/02/15/senate-poised-to-settle-for-symbolic-rebuke-as-russia-sanctions-talks-fizzle-00009096.

[12] Never Yielding Europe's Territory Act, 117th Cong., 2nd Session (2022), available at: https://www.foreign.senate.gov/imo/media/doc/DAV22128%20FINAL.pdf.

[13] Office of Foreign Assets Control, Directive 1 as Amended Under Executive Order 12622, (Sept. 29, 2017); Office of Foreign Assets Control, Directive 2 as Amended Under Executive Order 13662, (Sept. 29, 2017).

[14] Never Yielding Europe's Territory Act, *supra*, note 12.