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Disparate US, EU and UK Sanctions Rules Complicate Multinationals' Exits From Russia

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Key Points

- Multinationals working to exit operations and investments in Russia face a process complicated by differences in U.S., U.K. and EU sanctions and export controls, as well as Russian countermeasures.
- The lists of sanctioned individuals and businesses differ in Western jurisdictions, as do the scope of many restrictions and the definitions of control and ownership.
- Exiting companies need to navigate the U.S., U.K. and EU restrictions as they manage day-to-day operations, conduct due diligence on counterparties, draft sale agreements and plan for any post-closing transitional services.

The withdrawal of Western companies from Russia in the wake of the war in Ukraine has garnered a lot of attention. But the process does not take place overnight, and many foreign companies that have operated in Russia face ongoing legal hurdles as they work to complete exits in 2023. That involves navigating a dense web of regulations promulgated by the U.S., U.K. and EU, which have consequential differences. In addition, Russia has begun imposing controls on some exits, adding another layer of complexity.

Below, we highlight important differences among the three primary sanctions regimes that companies must factor in when planning an exit.[1]

Overlapping but Varied Restrictions

Historically, the U.S. has been the most aggressive in imposing and enforcing economic sanctions and export controls. Before Brexit, the U.K.'s rules typically mirrored the EU's. This year, however, all three jurisdictions have created independent, robust regimes targeted at Russia, with the U.K. and EU frequently staking out more aggressive sanctions positions.

The three have generally sought to thematically align the measures they impose, but divergences among the regimes have complicated compliance for multinational companies with distributed operations and an array of jurisdictional touchpoints. These restrictions have affected the management of day-to-day operations for companies as they plan for exit, as well as the way exit transactions are carried out. In some cases, multinationals may also have to consider rules imposed by Switzerland, Australia, Canada, Japan and other countries.

Navigating Sanctions While Preparing for Exit

Because the process of reaching and closing a deal can be protracted, companies must consider how to operate in Russia in the meantime — *e.g.*, how to pay rent, utilities, taxes, payroll and intercompany loans. Sanctions have made these routine activities difficult. Employees' accounts may be at sanctioned banks, global credit card networks have suspended services in Russia and there are restrictions on the entities and individuals with which U.S., U.K. and EU entities operating in Russia may deal.

1 These articles are for informational purposes only and do not constitute legal advice. Complex assessments often have to be made as to which sanctions regime applies in any given instance, given the multinational touch points of many entities and individuals. In that regard, given the complex and dynamic nature of these sanctions regimes, there may be developments not captured in these summaries. Moreover, while the summaries were accurate when written, they may become inaccurate over time given developments. For all of these reasons, you should consult with a qualified attorney before making any judgments relating to sanctions, as there are potentially severe consequences of failing to adhere fully to sanctions restrictions.

Restrictions on software and hardware exports may also impinge on day-to-day operations.

Here are some of the key differences in U.S., U.K. and EU sanctions rules that can come into play while companies wind down a business or seek a potential buyer.

Sanctions Targets

The U.S., U.K. and EU have sanctioned Russian targets since 2014, when Russia annexed Crimea. The scale and pace of new sanctions targets has significantly increased since the February 2022 Russian invasion of Ukraine, with important differences in the three jurisdictions' lists of sanctioned individuals and entities. For multinationals that operate their Russian business or dealings with Russian counterparties through multiple corporate offices or subsidiaries, these jurisdictional differences have frequently resulted in the need to reconsider existing structures, workflows and supply chains to ensure only those offices, systems and personnel permitted to engage with the relevant Russian party do so.

A key divergence in the regimes has been a heightened focus by the U.K. on sanctioning wealthy Russians outside government. In adding individuals and companies to its sanctions lists, the U.K. appears to have focused on those with the greatest economic interest in the U.K. Given the automatic application of sanctions to certain entities owned or controlled by listed persons (see discussion below), the U.K.'s approach has had far-reaching implications for multinationals that have dealings with the often vast business holdings some sanctioned wealthy Russians maintain.

Ownership Versus Control

The U.S. has long maintained a "50% rule" in applying sanctions to nonlisted entities held by sanctioned parties, a relatively straightforward criterion based solely on ownership. If a sanctioned person owns 50% or more of a legal entity, that entity will be considered a sanctioned business. There is no separate U.S. control test for the automatic application of sanctions to a nonlisted entity.

EU and U.K. blocking sanctions, however, apply where there is either ownership or control. An entity falls under the sanctions when over 50% of it is owned, directly or indirectly, by a person listed by one of their jurisdictions. Thus, in contrast to the U.S., a 50-50 joint venture with a listed person is not automatically subject to sanctions.

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Significantly, EU and U.K. sanctions generally also apply to any entity "controlled" by a person on their respective lists, so such entities can be subject to the prohibitions even if the sanctioned party's ownership interest does not exceed 50%. Control involves a much less clear-cut, more fact-specific analysis than ownership. Moreover, the definitions of control in the EU and U.K. are different, and the information required to test for control may not be readily available, or Russian counterparties may be unwilling to provide it. Discrepancies in the application of the control test by parties in the private sector, and thus whether an entity is sanctioned, have sometimes resulted in market confusion.

Investment Bans

Though the U.S., U.K. and EU have each imposed a ban on new investment in Russia, the scope of those bans differ, as do the jurisdictions' approaches to exclusions from the bans.

The U.S. has the broadest investment ban, restricting any new "commitment of capital or other assets for the purpose of generating returns or appreciation." "New investment" includes any purchase of equity or extension of credit, and the ban extends not only to investment in a company located in Russia but can also apply to a new investment in a company located outside of Russia that derives a predominant portion of its revenues from its investments in Russia. Maintenance of preexisting activities is generally carved out, but expansion is prohibited. Similarly, transactions in furtherance of divestment of a preexisting investment in Russia are generally not prohibited by the new investment restrictions.

By contrast, the EU investment ban is much more limited in scope. It prohibits investments in non-EU entities operating in the energy sector in Russia. Within this sector, the ban prohibits the:

- purchase of equity;
- creation of joint ventures; and
- provision of loans, credit or financing.

Under narrow circumstances, EU entities can apply for authorizations, but there is no general authorization mechanism for divestments or exit transactions. As a result, the prohibition of loans, credit and financing requires particular attention in an exit context.

The U.K. ban does not apply to as wide an array of "investments" as the U.S. one, but it is still broad. It focuses on:

- direct acquisitions of land;
- interests in legal entities connected with Russia;
- joint ventures and the opening of representative offices, branches or subsidiaries in Russia; and
- any related investment services.

Indirect acquisitions of land, interests in legal entities connected with Russia and establishing joint ventures with persons connected with Russia are also prohibited where these activities are for the purpose of making funds or economic resources available to a person connected with Russia or for their benefit. There are no carve-outs for divestments related to Russia, although there are exceptions set out in the legislation, including for the satisfaction of some prior obligations.

Bans on Provision of Services

The three jurisdictions have all banned the provision of certain services to persons located in Russia. While there is overlap in these bans, there are also significant differences in the prohibitions and corresponding exceptions, which have yielded a web of compliance complications for companies.

The U.S. has banned the provision of accounting (including audit), trust and corporate formation, management consulting and quantum computing services to persons located in Russia, or where the benefit of the service is ultimately received by a person in Russia. Importantly, the U.S. has excluded from these prohibitions any service to an entity in Russia that is owned or controlled by a U.S. person (*i.e.*, any U.S. citizen (including dual citizens) or permanent resident, any entity organized under U.S. laws or under any jurisdiction within the U.S. (including its foreign branches), and any person while physically present in the U.S.), and any service in connection with the wind-down or divestiture of an entity in Russia (unless that entity is owned by a Russian person). These exceptions have made maintaining operational links between U.S. companies and their subsidiaries in Russia more manageable. Effective December 5, 2022, the U.S. also banned the provision of certain services related to the maritime transport of crude oil of Russian origin.

The U.K. has banned the provision of professional and business services to persons connected with Russia, which like the U.S. includes certain accounting, business and management consulting services as well as public relations services. Unlike the U.S. and EU, however, the U.K. has not included an exemption for services to U.K. subsidiaries. Instead, it has indicated in guidance that a license may be granted for services required by non-Russian business customers in order to divest from Russia, to wind down other business operations in Russia or for services to a person connected with Russia by a U.K. parent company or U.K. subsidiary of that parent company. This affirmative licensing requirement has complicated intragroup operations for many multinationals. Separately, the U.K. has also announced that it will soon prohibit the provision of IT consultancy, architecture, engineering, advertising, auditing and certain transactional legal advisory services.

The EU has similarly banned the provision of accounting, architectural, auditing, bookkeeping, IT consultancy, engineering, legal advisory, tax consulting, business and management consulting, and public relations services to legal persons established in Russia. There is an exemption, however, for subsidiaries of entities incorporated or constituted in the EU, the European Economic Area, Japan, South Korea, Switzerland, the U.K. or the U.S.

Russian Restrictions

Recently, Russia has imposed its own restrictions that complicate exits and make them more unpredictable. For example, most direct and indirect transfers of any type of a Russian subsidiary now require an approval by the Russian Government Commission for Control Over Foreign Investments if a multinational from an "unfriendly" country (*i.e.*, one that commits "unamicable" actions against Russian legal entities and individuals) is involved.

In addition, transactions involving direct or indirect transfers of an equity stake in, among others, certain named banks and companies engaged in the energy and related sectors are banned unless approved by the Russian president himself. The companies listed include a number of Russian subsidiaries of international banks and energy companies.

Best Practices for Exit Transactions

The exit transaction process itself presents challenges. As with other stages of the exit, companies must pay heed to an array of cross-jurisdictional sanctions considerations.

Evaluate potential buyers. It is vital to understand and assess one's potential counterparties, the source of a buyer's financing, who the intermediaries (if any) are and which banks are involved. With non-Russian parties often hesitant to make new investments in Russia in the current geopolitical environment, most potential purchasers in exit transactions are Russian parties. Given the large number of Russian sanctions targets across the U.S., U.K. and EU sanctions regimes and the continuing targeting of additional individuals and entities, the pool of qualified buyers in several sectors has narrowed, and the risk of potential sanctions touchpoints has increased. In a number of circumstances, restrictions have left local management teams as the only possible buyers.

Monitor changes in sanctions. Sanctions in one or more jurisdictions can change midway through a transaction, presenting new obstacles or prohibiting completion. Transactions are taking much longer to close, particularly where regulatory approval is needed, making this risk more pronounced. In many cases, there is extensive press coverage of the exit, so a company's compliance with sanctions may come under governmental or public scrutiny.

Maintain continuous, two-way communication. Deal teams need to be informed of any sanctions modifications that could affect the transaction and they, in turn, need to keep counsel apprised of any changes in the structure or important terms of the deal to ensure they are compliant. It may be necessary to "wall off" certain offices or employees from any involvement in a transaction due to the sanction that would apply to them. There are sanctions risks not only for the parties to the transactions but also for third-party advisers, and there may be occasions where a third-party adviser's involvement invokes an added jurisdictional nexus that would not otherwise have been present in the transaction.

Seek appropriate authorizations. Understanding up front whether any governmental authorizations are required to complete the exit transaction is essential. Licenses can, in the ordinary course, take months to receive, and regulators in the U.S., U.K. and EU are currently inundated with requests for Russia-related guidance and licenses. Timely engagement with relevant regulators can provide early indication of the likelihood a regulator may grant the necessary authorization and mitigate the risk of delays in an exit transaction timeline.

Furthermore, EU sanctions regulations typically predefine certain circumstances under which a competent authority can grant an authorization. That means the authorities have limited wiggle room, so parties should determine at the outset of a transaction whether there is legal authority to approve certain types of activities.

Protect against Russian law risks. While the exit process is underway, companies need to take steps to guard against putting their employees in Russia at risk of liability for violations of local law.

Review deal terms. Care must be taken to ensure terms are consistent with all applicable sanctions rules. Questions can arise, for example, with restructuring steps to prepare for sale, potential payment arrangements (*e.g.*, deferred payments), call options or other rights for the exiting party to claw back the sold business, transitional services and transfers of equipment or technology.

Assess whether transitional services are compliant. Post-closing transitional services agreements are often necessary to facilitate the transfer of a business, particularly where a Russian business was substantially dependent on its parent or a non-Russian affiliate, or a buyer does not have the capacity to provide full business support immediately upon closing. Any planning for the provision of transitional services requires close review to evaluate whether any may be prohibited and whether any previously relied-on exceptions may not be available post-closing. In addition, any transitional services agreement should be carefully drafted to ensure they can be modified or terminated as necessary to comply with relevant future sanctions.

Pay attention to disclosure obligations. As the exit processes unfold, publicly traded companies will need to bear in mind their disclosure obligations to investors, and regulated business such as banks and insurers may need to keep their regulators apprised of developments.

(See also "Why Directors and Executives Need To Pay Attention to Sanctions, Money Laundering and Export Rules.")