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Continued Focus on Circumvention: the EU's 14th Package of Sanctions

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Summary

On 24 June 2024, the EU introduced its 14th package of sanctions on Russia (the "14th Sanctions Package"). These follow recently introduced restrictions by the USA (through OFAC on 12 June 2024) and the UK (through OFSI on 13 June 2024). Amongst other things, the 14th Sanctions Package significantly expands the EU's recent focus on the introduction of new anti-circumvention measures.

These include:

- A legislative clarification that 'circumvention' will include circumstances where individuals or companies can be found to be knowingly and intentionally circumventing sanctions where they seek the outcome of circumvention, and also in circumstances where they disregard the consequences of their participation in the relevant activity.
- A series of interesting anti-circumvention measures in relation to exports, which impose proactive compliance obligations on companies exporting certain goods or technologies from, or through, the EU, including:

  (i) tweaks to the existing 'no Russia clause' requirements, to include an exemption for contracts with SOEs but the imposition of a related reporting obligation;

  (ii) the extension of these 'no Russia clause' requirements to IP licencing agreements; and

  (iii) the imposition of obligations on certain companies to implement appropriate anti-diversion policies and procedures, and to conduct proactive risk assessments.
- Amendments to make clear that EU natural and legal persons, entities and bodies ("EU Entities") that own or control a legal person, entity or body established outside the European Union ("non-EU Subsidiary") have a duty to ensure that those non-EU Subsidiaries do not participate in activities that undermine EU sanctions regulations. These amendments reiterate the EU's position - companies operating in or through the EU should take note.

A major focus of legislative and, increasingly, enforcement, activity by Western allies is on the diversion of prohibited goods to Russia, via third states. This looks set to continue. The EU's new and expanded proactive compliance obligations in particular, are extensive. They may require action from a broad group

of companies, given the breadth of the affected areas, including goods (and technologies to produce the same) set out in the List of Common High Priority Items. This is a broad list, including for instance microelectronics (electronic integrated circuits); electronics items related to wireless communications, satellite-based radio-navigation and passive electronic components; and, items essential for the manufacturing of high precision complex metal components retrieved from battlefield.

Restricting diversion of these 'common high priority items' is the key area of focus for future Russia sanctions enforcement activity.

'Best efforts' to ensure subsidiaries do not undermine sanctions?

Article 8 of Regulation (EU) No 833/2014 has been updated - including, with the introduction of a "best efforts" provision (Article 8a), through which EU Entities will be obliged to ensure (through their best efforts) that any non-EU Subsidiaries, do not participate in activities that undermine the EU sanctions regulations. Many EU Entities will already have implemented policies and procedures in this regard; nonetheless, this provision should be taken into consideration as EU Entities review their approach to exercising control over their non-EU Subsidiaries' activities.

Amendments to the concept of circumvention?

Article 12 has been amended, apparently so as to broaden the scope of the definition of circumvention in the Regulations such that it is clear that circumvention includes circumstances where a person participates in activities, does not intend that the object or effect of these is circumvention, but is aware that the participation may have that object or effect, and accepts that possibility .

In other words, circumvention of EU sanctions can occur where a company or its employees engage in commercial activity that they anticipate may have the effect of circumventing sanctions, for instance by leading to the diversion of restricted products to Russia, but they do not know that will be the effect and do not intend for it to occur. In essence, turning a blind eye will not - if it ever did, which is doubtful - prevent liability for circumvention.

This change is arguably less impactful than it may seem, as most companies have been adopting broad interpretations of circumvention. However, this enhancement to the explicit scope of the provision may change some organisations' risk calculus in relation to higher risk transactions.

Tweaks to the 'no Russia clause' (Article 12g)

The prior version of the 'no Russia clause' in essence, required EU Entities to, subject to an implementation period, include contractual provisions preventing the re-export to Russia in all contracts relating to the export from the EU of items on the List of Common High Priority Items. This has been highly impactful for many companies given the:

- requirement has, from 20 March 2024, applied to new agreements (contracts concluded as of 19 December 2023);

- requirement will, from 20 December 2024, apply to historic agreements (contracts concluded before 19 December 2023) which need to be re-executed; and
- breadth of the List of Common High Priority Items.

The 14th Sanctions Package has amended this clause such that it now includes an exemption in respect of public contracts with "public authorities" in third countries or with international organisations. There is likely to be some lack of clarity in relation to the scope of the "public authorities" impacted, which companies will have to grapple with.

EU exporters benefitting from the exemption will have a reporting obligation whereby they must, within two weeks from the conclusion of any such public contract, inform the competent authority of the Member State in which they are resident / established. That may pose its own challenges.

'No Russia' clauses in IP licencing agreements

To continue to mitigate the risk that items from the List of Common High Priority Items could be exported to Russia or for use in Russia, EU Entities will, from 26 December 2024, have to comply with certain requirements to increase diligence when contracting.

Article 12ga requires EU Entities that sell, licence or transfer intellectual property rights or trade secrets and grant rights to access or re-use material or information protected by intellectual property rights or as a trade secret relating to common high priority items, to insert contractual provisions that prohibit third-country counterparties from using such intellectual property rights, trade secrets or other information in connection with common high priority items intended to be, directly or indirectly, sold, supplied, transferred or exported to Russia or for use in Russia.

This obligation has a broad reach as EU entities will have to ensure that third-country counterparties prohibit possible sublicensees of such intellectual property rights or trade secrets from such usage.

EU Entities have a reporting obligation to the Member State in which they are resident / established, should they become aware of a breach of any of these contractual obligations by the third-country counterparty.

Mandatory due diligence

Article 12gb introduces due diligence measures for EU Entities that sell, supply, transfer or export items from the List of Common High Priority Items unless this activity is within the EU or to partner countries listed in Annex VIII of the Regulation (EU) No 833/2014.

EU Entities must take appropriate steps, proportionate to their nature and size, to identify and assess the risks of exportation to Russia / for use in Russia for common high priority items. Risk assessments must be documented and maintained so they are up to date.

Additionally, EU Entities must implement appropriate policies, controls and procedures, proportionate to their nature and size, to mitigate and effectively manage risks of exportation to Russia / for use in Russia for common high priority items - regardless of whether the risk has been identified by the EU Entity, a Member State or the EU.

Finally, EU Entities will be required to ensure that any non-EU Subsidiary that sells, supplies, transfers or exports common high priority items, implements the necessary risk assessment and policies, controls and procedures to comply with the Regulations. An EU Entity would be exempt from this requirement where, for reasons that it did not cause itself, it is unable to exercise control over its non-EU Subsidiary.

Implications

The introduction of further proactive obligations on companies exporting items on the List of Common High Priority Items (i.e. Articles 12ga and 12gb) will inevitably increase the compliance burden on EU Entities. Compliance teams will need to "zoom out" to understand the risk profile across the organisation and then, "zoom in" to implement an effective approach to conducting the necessary diligence.

Companies may find that bespoke policies, controls and procedures will need to be prepared, cascaded throughout the business (including through training front-line staff) and monitored for effectiveness. Many companies already have such controls in place; the focus for these will now grow and efforts may be necessary to adapt to the Regulations and any future guidance. Where companies do not have such controls in place, they now risk breach of EU sanctions regulations merely by failing to have in place adequate controls - regardless of whether circumvention may or may not take place.

Similarly, a risk-assessment that appropriately manages and mitigates the specified risks may need to be developed. Pending any guidance, risk assessments are likely to be organisation-wide (rather than a more onerous obligation requiring each contract within scope to be tracked and risk assessed individually) but it is likely that appropriate risk assessments will need to identify specific high-risk contracts, or categories thereof, as well as document the measures taken to mitigate those risks (i.e. appropriate due diligence).

What's Next?

Given the requirement to comply with Articles 12ga and 12gb takes effect from 26 December 2024, EU Entities have a six-month period to prepare from a commercial and operational perspective. The EU may, in due course, issue guidance that clarifies the manner in which these new requirements should be implemented.

Key actions that companies should consider include:

1. Mapping potential areas of exposure across operations and supply chains, which could come within the scope of the obligations of Articles 12ga and 12gb. This should reflect, and where necessary expand on, exercises already conducted in order to seek to comply with Article 12g.
2. Considering what internal policies and processes are already in place, and what may be necessary to introduce to most effectively manage and mitigate the risk of exportation to Russia / for use in Russia of common high priority items.
3. Confirming the approach currently taken in respect of monitoring the risk associated with non-EU Subsidiaries, and determine whether this is compliant or needs to be modified.

Please contact Simmons & Simmons should you have any questions or if it would be useful to discuss the potential implications of this latest development, in respect of your organisation.