Hitting 'Em Where it Hurts: Canada Targets Russian Energy Sector in Latest Round of Economic Sanctions

On the heels of announcements by the US and the EU, the Canadian Government has significantly expanded its sanctions against Russia and the Ukraine. In addition to lists of further persons with whom it is prohibited to do business, Canada has clarified the scope of existing financial sanctions and fulfilled a promise made by the Prime Minister in the summer[1] to follow the US and EU targeting of Russian oil and gas sectors. This is the first use of sector-specific sanctions by Canada.

1. Canadian amendments to Russia economic sanctions

On December 19, 2014, Canada enacted the *Regulations Amending the Special Economic Measures (Russia) Regulations* (SOR/2014-316) (the "Russia Sanctions"). These amending regulations contain new sanctions and clarifications, including a prohibition against new contracts for the export, sale, supply or shipment of certain goods to Russia for use in deep-water, arctic or shale oil exploration and production, along with a prohibition against the provision of services related to these goods.

[1]Prime Minister's Office, "*Statement by the Prime Minister of Canada announcing additional sanctions*" (6 August 2014).

a. New energy sanctions for contracts entered into after December 19, 2014

The Russia Sanctions now prohibit any person in Canada, and any Canadian outside Canada, to export, sell, supply or ship any goods listed on Schedule 4 of the Regulations, wherever situated, to Russia or to any person in Russia for use in

1. offshore oil exploration or production at a depth greater than 500 metres;
2. oil exploration or production in the Arctic; or
3. shale oil exploration or production.

The Schedule 4 list of sanctioned commodities mirrors the lists established by the US and the EU earlier in 2014. It includes such items as line pipe, drill pipe, casing and tubing, pumps, liquid elevators, drilling and boring tools, and excavation machinery.

The Russia Sanctions also prohibit the provision of financial, technical or other services related to any good whose export, sale, supply or shipment is prohibited. Similarly, they prohibit indirect conduct which may cause, assist or promote any prohibited conduct.

However, these new energy prohibitions do not apply to goods or services if the contract for the export, sale, supply or shipment of the good or for any related service is entered into before December 19.

b. Clarification of debt and equity financing prohibitions

The Russia Sanctions clarify that the new debt financing prohibitions against Schedule 2 and 3 listed persons (i.e. persons to whom the prohibitions against new debt financing apply) include the following types of new debt transactions: bonds, loans, debentures, extensions of credit, loan guarantees, letters of credit, bank drafts, bankers' acceptances, discount notes, treasury bills, commercial paper and other similar instruments.

The equity financing prohibition in the Russia Sanctions has also been amended. The original capital funding language has been clarified and now prohibits any financing or other dealings in new securities, including shares or any other ownership interest in relation to the persons listed in Schedule 2.

c. Additional Russian and Ukrainian individuals sanctioned

Eleven additional Russian separatists have been added to the Russia Sanctions.

Canada also issued the *Regulations Amending the Special Economic Measures (Ukraine) Regulations* (SOR/2014-317) (the "Ukraine Sanctions") on December 19, 2014 to sanction an additional 9 separatist leaders in the Ukraine, all of whom have been previously listed by the EU. These amendments to the Ukraine Sanctions do not impose any other prohibitions.

2. United States amendments to Russian economic sanctions[2]

a. Clarification of oil sector prohibition

The US Office of Foreign Assets Control ("OFAC") released new *FAQ*s on December 11, 2014 clarifying the oil sector prohibitions in Directive 4. The prohibitions do not cover 1) the provision of goods, services and technology relating to the refining of oil or other dealings involving oil that has been extracted from a deepwater, Arctic offshore, or shale project and transported off a field production site is not prohibited; and 2) arctic offshore projects do not include refineries which process arctic offshore oil, but are limited to drilling operations located above the Arctic Circle. Canada has not provided guidance as to whether it has established a similar exemption in its Russia Sanctions.

[2] The general information on US sanctions is provided only in summary form as context for understanding how Canada's approach to sanctions of Russia and the Ukraine has been evolving.

b. US economic embargo against Crimea and additional blocked persons

On December 19, 2014 the United States issued a new *Executive Order* to tighten its economic embargo against Crimea (which excludes the sale of agricultural commodities, medicine, and medical supplies to Crimea pursuant to *General License 4*) by prohibiting the following types of conduct:

- new investment in the Crimea region of Ukraine by US persons;
- the importation of any goods, services, or technology from the Crimea region of Ukraine into the United States;
- the exportation, re-exportation, sale, or supply of any goods, services, or technology from the United States to the Crimea region of Ukraine; and
- any approval, financing, facilitation, or guarantee by a US person of any such transaction by a foreign person.

Canada has not imposed restrictions akin these US economic embargo measures against the Crimea region.

The US also imposed sanctions on December 19, 2014 against 24 additional Ukrainian and Russian separatists and the militias or entities they lead or support, including Marshall Capital Partners (a Russian equity investment group) and Profaktor, Tov (a Ukrainian accounting, auditing and bookkeeping firm). No extractive sector entities were named in this round of US sanctions.

3. European Union amendments to Russia economic sanctions[3]

a. Economic embargo against Crimea

On December 18, 2014 the European Union issued Council Regulation No 1351/2014, effective December 20, 2014, to broaden its economic embargo against Crimea and issued lists of sanctioned goods (in Annex II) and Crimean ports (in Annex III).

This new EU regulation basically prohibits all foreign investments and related services in Crimea or Sevastopol as well as the sale, supply, transfer or export of Annex II goods and technologies suited for use in the following sectors in Crimea or Sevastopol: energy; prospecting, exploration and production of oil, gas and minerals; transport; and telecommunications. It prohibits direct or indirect technical or financial assistance, brokering services, provision, manufacture, maintenance, or financing of the goods and technology listed in Annex II. Similarly it prohibits technical assistance, brokering, construction or engineering services directly relating to infrastructure in Crimea or Sevastopol in the above-listed sectors. These prohibitions effectively broaden the former export prohibition on goods and technology in the sectors of energy and exploitation of oil, gas and minerals, transport, telecommunications. However, these prohibitions do not apply to the execution of an obligation until March 21, 2015 arising from contracts concluded before December 20, 2014.

As mentioned above, Canada has not imposed measures expressly targeting the Crimea nor Sevastopol regions.

b. Guidance on sectoral sanctions

On December 16, 2014, the EU released a 26 frequently asked questions and answers (FAQs) regarding the sanctions it imposed on

[3] The general information on EU sanctions is provided only in summary form as context for understanding how Canada's approach to sanctions of Russia and the Ukraine has been evolving.

July 31, 2014[4] which consist of restrictions on access to certain sensitive technologies particularly in the oil sector, an export ban for dual use goods for military end use and end users, and measures aimed at limiting access to EU capital markets for Russian state-owned financial institutions. This *guidance* clarifies both the financial assistance measures and the financial service measures. For example, FAQ 1 clarifies that the EU's prohibition on dual-use exports to Russia for military end-users or military end-use also applies to "payment services and issuance of letters of guarantees/credit" linked to transactions involving these prohibited exports. None of the oil sector prohibitions are addressed in this guidance.

Conclusion

The US, EU and Canadian sanctions introduced on December 18-20, 2014 are extensive and came without much warning. Canada's amendments bring it into general alignment with the US and EU effort to target the oil and gas sector as a key area. Not surprisingly, Russia has indicated an intention to introduce retaliatory measures.[5] Companies involved in cross-border trade of goods or services as well as investment and financing transactions will need to monitor developments in order to ensure ongoing compliance with increasingly complex and technical levels of restrictions. As noted in our previous bulletins,[6] the consequence for not doing so can be severe.

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[4] Through the adoption of *Council Regulation (EU) No. 833/2014*, as amended on September 8, 2014 by *Council Regulation (EU) No 960/2014* and on December 4, 2014 by *Council Regulation (EU) No 1290/2014*.

[5] "*Russia to consider possible response to US, Canada sanctions — Kremlin aide*" (22 December 2014), ITAR-TASS.

[6] Martin Masse and Monica Podgorny, "*Canada, US and the EU Expand Their Lists of Economic Sanctions against Russia and the Ukraine*" McMillan LLP (July 2014) and Martin Masse and Monica Podgorny, "*Staying Out of the Crosshairs – Keeping On Top of Russia Related Economic Sanctions*" McMillan LLP (November 2014).

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a cautionary note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.