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License to Drill: The OFAC Licensing Regime and How to Obtain Clearance to Invest in Russian Financial and Commodities Markets

Zachary Z. Zermay¹

I. INTRODUCTION

Russia is the largest country in the world. It has the largest natural gas reserves of any country, invaluable natural resources located in the rapidly thawing Siberia, a strong defense industry, a respectable financial center, and access to both the Atlantic and Pacific oceans. The one-two punch of falling oil prices coupled with economic sanctions stemming from Russia's re-assertion of control over the Crimean Peninsula has harmed the Russian economy. However, these unique economic challenges present an interesting opportunity for investors who know how to navigate regulatory minefields to make investments without running afoul the law. This paper will analyze the Office of Foreign Assets Control's ("OFAC") regulatory paradigm, and the Russian laws and regulations which impact the oil and gas, defense, and banking sectors. Finally, it will analyze ExxonMobil's failed application to OFAC for a specific license to do business with a sanctioned Russian oil company.

II. RELEVANT EXECUTIVE ORDERS

President Barack Obama implemented a number of executive orders which have harmed the Russian economy and currently hamper Americans' ability to freely invest there. The orders were issued under the authority conferred to the president under the International Emergency Economic Powers Act, the National Emergencies Act, and the Immigration and Nationality Act

¹ The University of Chicago Law School, JD 2017; Florida State University, College of Social Sciences and Public Policy, MS 2014; Florida State University, College of Social Sciences and Public Policy, BS 2013. Thanks to Professor Tom Ginsburg for supervising this independent research paper. Thanks also goes out to the law faculties and students of Lomonosov Moscow State University, The National Research University Higher School of Economics, and Saint Petersburg State University for their insightful comments and hospitality while conducting this research in Russia.

of 1952. Obama signed these orders because of the “unusual and extraordinary threat to the national security and foreign policy of the United States” that Russia’s actions in Crimea presents, and because of the “increasing prevalence and severity of malicious cyber-enabled activities originating from [...] outside the United States” which allegedly impacted the 2016 American presidential election.² It is important to note that Obama also implemented an executive order which banned “all direct and indirect transactions (including financial, trade, and other commercial transactions) by U.S. persons or within the United States to or from Crimea unless authorized by OFAC or exempted by statute,” however, this paper is more concerned with the laws and orders which impact areas outside of the Crimean Peninsula.³ The relevant provisions from first round of the executive orders which were implemented as a result of the Crimean crisis is below.

Section 1.

(a) All property and interests in property that are in the United States, that hereafter come within the United States, or that are or hereafter come within the possession or control of any United States person (including any foreign branch) of the following persons are blocked and may not be transferred, paid, exported, withdrawn, or otherwise dealt in: any person determined by the Secretary of the Treasury, in consultation with the Secretary of State:

(i) to be responsible for or complicit in, or to have engaged in, directly or indirectly, any of the following:

(A) actions or policies that undermine democratic processes or institutions in Ukraine;

²Exec. Order No. 13660, 79. Fed Reg. 46 (Mar. 10, 2014) https://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo.pdf; Exec Order 13694, 80 Fed. Reg. 63 of (Apr. 1, 2015) https://www.treasury.gov/resource-center/sanctions/Programs/Documents/cyber_eo.pdf.

³ Office of Foreign Assets Control, *Crimea Sanctions Advisory*, https://www.treasury.gov/resource-center/sanctions/Programs/Documents/crimea_advisory.pdf.

(B) actions or policies that threaten the peace, security, stability, sovereignty, or territorial integrity of Ukraine; or

(C) misappropriation of state assets of Ukraine or of an economically significant entity in Ukraine;

(ii) to have asserted governmental authority over any part or region of Ukraine without the authorization of the Government of Ukraine;

(iii) to be a leader of an entity that has, or whose members have, engaged in any activity described in subsection (a)(i) or (a)(ii) of this section or of an entity whose property and interests in property are blocked pursuant to this order;

(iv) to have materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of, any activity described in subsection (a)(i) or (a)(ii) of this section or any person whose property and interests in property are blocked pursuant to this order; or

(v) to be owned or controlled by, or to have acted or purported to act for or on behalf of, directly or indirectly, any person whose property and interests in property are blocked pursuant to this order.

(b) The prohibitions in subsection (a) of this section apply except to the extent provided by statutes, or in regulations, orders, directives, or licenses that may be issued pursuant to this order, and notwithstanding any contract entered into or any license or permit granted prior to the effective date of this order.

Section 1 of this executive order has the function of freezing the assets of individuals who have had a hand in helping Russia take control of the Crimean Peninsula. This section is extremely relevant to the Russian elite who have transferred their assets out of Russia and placed them into American bank accounts and investment funds. While the assets are still technically the property of the sanctioned person or entity, they cannot reach them or exercise the right to

control their property in any meaningful way. Section 1's covered persons' list is cross referenced in other sections of the order, like Section 4 which is below:

Section 4. The prohibitions in section 1 of this order include but are not limited to:

- (a) the making of any contribution or provision of funds, goods, or services by, to, or for the benefit of any person whose property and interests in property are blocked pursuant to this order; and
- (b) the receipt of any contribution or provision of funds, goods, or services from any such person.

This section cross references Section 1 and effectively prohibits Americans from doing business with the individuals whose assets were frozen due to their alleged involvement in overthrowing the Ukrainian government in Crimea. This provision is extraordinarily important because it broadly bans any kind of economic engagement with those who are targeted by the order. An individual cannot even structure a transaction to get around this order because of the Section 5, which is below.

Section. 5.

- (a) Any transaction that evades or avoids, has the purpose of evading or avoiding, causes a violation of, or attempts to violate any of the prohibitions set forth in this order is prohibited.
- (b) Any conspiracy formed to violate any of the prohibitions set forth in this order is prohibited.⁴

While this paper does not seek to give aid to individuals or corporations attempting to evade and avoid American sanctions, it is important to ascertain what acts would qualify as such.

⁴ Exec. Order No. 13660, 79. Fed Reg. 46 (Mar. 10, 2014).

There is not much information or guidance from The Department of Treasury (“Treasury Department”) regarding what actions it would consider to be evading or avoiding the order. OFAC has argued that giving legal advice to individuals who may be covered by sanctions is the facilitation of evading and avoiding sanctions.⁵ A district court slammed this broad interpretation in a criminal case which stemmed from customs agents who stripped an attorney of his documents charged him with evading sanctions.⁶ The court wrote that the “Constitution certainly cannot abide the Kafkaesque interpretation that OFAC proposes—that the [...] sanctions prohibit, at the whim of OFAC regulators, any effort to structure transactions with the purpose of complying with the remainder of the [...] sanctions regulations, including any attempt to hire an attorney for guidance.”⁷

ING Bank was whacked with a deferred prosecution agreement for evading and avoiding sanctions. They processed and “advised clients in sanctioned countries on how to conceal their involvement in U.S. dollar transactions, allowed clients to use shell companies to conceal transactions with specially designated nationals, and used misused ING Bank internal suspense accounts to process payments from U.S. sanctioned countries and entities.” It would seem like most individuals and corporations who run afoul this provision of the sanctions regime do so by failing to document who the transaction involves or by actively concealing it by using shell corporations and corporate entities to hide the true recipient.

Turning back to Section 1 of this order, the Treasury Department is empowered to designate individuals, state entities, and corporations as specially designated nationals. The Treasury Department publishes its directives and a Sectorial Sanctions Identification List to put

⁵ *Looper v. Morgan*, No. H-92-0294, 1995 U.S. Dist. LEXIS 10241, at 1 (S.D. Tex. June 30, 1995).

⁶ Smith, Gambrell, & Russell LLP, *Doing Business With The Enemy*, http://www.sgrlaw.com/ttl-articles/860/#fn_

⁷ *Looper v. Morgan*, No. H-92-0294, 1995 U.S. Dist. LEXIS 10241, at 49 (S.D. Tex. June 30, 1995).

both the public and targeted entities on notice. As of May 5, 2017, that list is 117 pages long.⁸

This list includes Russia's state oil company, Rosneft, Russia's state gas company, Gazprom, Russia's state arms exporter, Rosoboronexport, and the Bank of Moscow. As a result, investors, importers, or exporters dealing in Russia's oil and gas, defense, and financial sectors must check this list or risk running afoul American sanctions. There are general licenses issued by OFAC which permit transactions that would otherwise be prohibited under the order. General licenses have been issued to allow Americans to supply Crimea with certain medical supplies, and to permit remittances to individuals who ordinarily live Crimea.⁹

III. CYBER-ACTIVITIES ORDER

Executive Order 13694 was signed to impose sanctions on individuals, organizations, and countries who engage in cyber espionage or terrorism. Every provision except for Section 1 is the same as the one which was signed into effect in the wake of the Crimean crisis. Section 1 is below.

Section 1.

(a) All property [...] that are or hereafter come within the possession or control of any United States person of the following persons are blocked and may not be transferred, paid, exported, withdrawn, or otherwise dealt in:

(i) any person determined [...] to be responsible for or complicit in, or to have engaged in, directly or indirectly, cyber-enabled activities originating from, or directed by persons located, in whole or in substantial part, outside the United

⁸ Office of Foreign Assets Control, *Sectoral Sanctions Identifications List*, <https://www.treasury.gov/ofac/downloads/ssi/ssilist.pdf>.

⁹Office of Foreign Assets Control, *General License No. 4 Authorizing the Exportation or Reexportation of Agricultural Commodities, Medicine, Medical Supplies, and Replacement Parts*, https://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_gl4.pdf; Office of Foreign Assets Control, *List of Medical Supplies*, https://www.treasury.gov/resource-center/sanctions/Programs/Documents/med_supplies_ukr.pdf; Office of Foreign Assets Control, *General License No. 6 Noncommercial Commercial Remittances Authorized*, https://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13685_gl_6.pdf.

States that are reasonably likely to result in, or have materially contributed to, a significant threat to the national security, foreign policy, or economic health or financial stability of the United States and that have the purpose or effect of:

- (A) harming, or otherwise significantly compromising the provision of services by, a computer or network of computers that support one or more entities in a critical infrastructure sector;
- (B) significantly compromising the provision of services by one or more entities in a critical infrastructure sector;
- (C) causing a significant disruption to the availability of a computer or network of computers; or
- (D) causing a significant misappropriation of funds or economic resources, trade secrets, personal identifiers, or financial information for commercial or competitive advantage or private financial gain; or

(ii) any person determined [...]:

- (A) to be responsible for or complicit in, or to have engaged in, the receipt or use for commercial or competitive advantage or private financial gain, or by a commercial entity, outside the United States of trade secrets misappropriated through cyber-enabled means, knowing they have been misappropriated, where the misappropriation of such trade secrets is reasonably likely to result in, or has materially contributed to, a significant threat to the national security, foreign policy, or economic health or financial stability of the United States;
- (B) to have materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services in support of, any activity described in subsections (a)(i) or (a)(ii)(A) of this section or any person whose property and interests in property are blocked pursuant to this order;
- (C) to be owned or controlled by, or to have acted or purported to act for or on behalf of, directly or indirectly, any person whose property and interests in property are blocked pursuant to this order; or

(D) to have attempted to engage in any of the activities described in subsections (a)(i) and (a)(ii)(A)–(C) of this section.

(b) The prohibitions in subsection (a) of this section apply except to the extent provided by statutes, or in regulations, orders, directives, or licenses that may be issued pursuant to this order, and notwithstanding any contract entered into or any license or permit granted prior to the effective date of this order.¹⁰

This was originally intended to be a response to the Democratic People’s Republic of Korea’s (“DPRK”) alleged hacking of Sony Pictures in retaliation for the film *The Interview* which mocked the DPRK’s supreme leader, Kim Jong-un and has been applied as such.¹¹ That was until the American presidential election of 2016 when American intelligence officials and politicians alleged that hackers supported by the Kremlin hacked the Democratic National Committee and former Secretary of State Hillary Clinton’s presidential campaign to hamstring her politically by revealing information to WikiLeaks.¹² President Obama in retaliation issued Executive Order 13757 which explicitly named the Federal Security Service (“FSB”) and Main Intelligence Directorate as sanctioned organizations under Order 13694. This would have been a major problem for American exporters who need to obtain licenses from the FSB to import their technology into the Russian Federation.¹³ However, the Trump Administration issued a general license to permit the following:

¹⁰ Blocking the Property of Certain Persons Engaging in Significant Malicious Cyber-Enabled Activities https://www.treasury.gov/resource-center/sanctions/Programs/Documents/cyber_eo.pdf

¹¹ Louis Dennig, *President Obama Signs Executive Order Authorizing Sanctions for Cyber Attacks, Use of Stolen Data*, <http://www.alstonprivacy.com/president-obama-signs-executive-order-authorizing-sanctions-for-cyber-attacks-use-of-stolen-data/>.

¹² Director of National Intelligence, *Background to “Assessing Russian Activities and Intentions in Recent US Elections”*: *The Analytic Process and Cyber Incident Attribution*, https://www.dni.gov/files/documents/ICA_2017_01.pdf.

¹³ Alexandra Baj, *OFAC Issues General License Authorizing Certain Dealings with FSB Related to Encryption Import Licensing*, <http://www.steptoeinternationalcomplianceblog.com/2017/02/ofac-issues-general-license-authorizing-certain-dealings-with-fsb-related-to-encryption-import-licensing/>.

- (1) Requesting, receiving, utilizing, paying for, or dealing in licenses, permits, certifications, or notifications issued or registered by the Federal Security Services [...] for the importation, distribution or use of information technology products in the Russian Federation, provided that [...] the payment of any fees to the Federal Security Service [...] does not exceed \$5,000 in any calendar year¹⁴

It is interesting to note that this is the only general exception to the cyber-activities order.

IV. DESIGNATED NATIONALS, ENTITIES, AND THE FIFTY PERCENT RULE

It is clear that an American company cannot do business with designated foreign nationals who are specifically sanctioned under executive orders or those who are determined to be covered by the orders by the Treasury Department. However, this plain looking rule becomes a bit murkier when dealing with a widely held public company which a designated national or entity owns a significant portion of. The Treasury Department issued guidance to potential investors and businessmen to help them avoid violating the sanctions.

The guidance states that “property blocked pursuant to an executive order or regulations administered by OFAC is broadly defined to include any property or interest in property, tangible or intangible, including present future or contingent interest” and a “property interest subject to blocking includes interest of any nature whatsoever, direct or indirect.”¹⁵ However, when it comes to whether a designated person or entity owns property, the Treasury Department specified that “persons whose property and interest in property are blocked [...] are considered to have an interest in all property and interests in property of an entity in which such blocked person own, whether individually or in the aggregate, directly or indirectly, a 50 percent or

¹⁴ Office of Foreign Assets Control, *General License Number 1, Authorizing Certain Transactions with the Federal Security Service* https://www.treasury.gov/resource-center/sanctions/Programs/Documents/cyber_gl1.pdf.

¹⁵ Department of the Treasury, *Revised Guidance on Entities Owned by Persons Whose Property and Interests in Property are Blocked*, https://www.treasury.gov/resource-center/sanctions/Documents/licensing_guidance.pdf.

greater interest.”¹⁶ As a result, such entities which are owned 50% or more by designated nationals or entities are “considered to be a blocked person” and “the property and interests in property of such an entity are blocked regardless of whether the entity itself is listed in the annex to an executive order or otherwise placed on OFAC’s list of Specially Designated Nationals” and an American company or person “may not engage in any transactions with such an entity” unless such transaction falls under a general or specific license issued by OFAC.

For corporations which are not majority owned by designated persons or entities, but where such designated persons or entities have a “significant ownership interest which is less than 50 percent or one which one or more blocked persons may control by means other than a majority ownership interest” OFAC still advises caution.¹⁷ This is because such entity may be “the subject of future designation or enforcement action.”¹⁸

V. GETTING OUT FROM UNDER THE SANCTIONS WITH SPECIFIC LICENSES

While the OFAC can issue general licenses to engage in otherwise proscribed conduct to the general public, it can also issue specific licenses to those who apply for them. The standards for when OFAC will grant a specific license to an applicant remains unclear though.

OFAC defines a specific license as “a written document issued by OFAC to a particular person or entity, authorizing a particular transaction in response to a written license application.”¹⁹ There is not much information available about why any given application gets approved or denied. OFAC briefly mentions that “each application is reviewed on a case-by-case basis and often requires interagency consultation. Although [OFAC] cannot predict how long

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ Office of Foreign Assets Control, *Basic Information on OFAC and Sanctions*, https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx#licenses.

this review might take, following existing application guidelines will help to expedite your determination.”²⁰

To ascertain what OFAC is looking for in a specific license application, it is helpful to look at the agencies mission statement to see what its goals are:

The Office of Foreign Assets Control (OFAC) of the US Department of the Treasury administers and enforces economic and trade sanctions based on US foreign policy and national security goals against targeted foreign countries and regimes, terrorists, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other threats to the national security, foreign policy or economy of the United States. OFAC acts under Presidential national emergency powers, as well as authority granted by specific legislation, to impose controls on transactions and freeze assets under US jurisdiction. Many of the sanctions are based on United Nations and other international mandates, are multilateral in scope, and involve close cooperation with allied governments.²¹

With this in mind, an applicant should look at why the president sanctioned the targeted country under his national emergency powers and try to explain why their transaction advances America’s strategic national interests on either policy or humanitarian grounds. In the case of the Ukrainian conflict, the preamble to the order states,

I, BARACK OBAMA, President of the United States of America, find that the actions and policies of persons -- including persons who have asserted governmental authority in the Crimean region without the authorization of the Government of Ukraine -- that undermine democratic processes and institutions in Ukraine; threaten its peace, security, stability, sovereignty, and territorial integrity; and contribute to the misappropriation of

²⁰ *Id.*

²¹ The Department of the Treasury, *Terrorism and Financial Intelligence Office of Foreign Assets Control Mission* <https://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx>.

its assets, constitute an unusual and extraordinary threat to the national security and foreign policy of the United States, and I hereby declare a national emergency to deal with that threat.²²

OFAC official's opinions are not the only ones that matter in the federal government when it comes to granting a specific license. OFAC "licensing determinations are guided by U.S. foreign policy and national security concerns. Numerous issues often must be coordinated with the U.S. Department of State and other government agencies, such as the U.S. Department of Commerce."²³ This utilization of advice from other administrative agencies has been blessed by the courts.²⁴

The OFAC appeal process is also very limited. OFAC states that a "denial by OFAC of a license application constitutes final agency action" and that the "regulations do not provide for a formal process of appeal." It does state however that it could potentially "reconsider its determinations for good cause, for example, where the applicant can demonstrate changed circumstances or submit additional relevant information not previously made available to OFAC."²⁵ Thus, apart from reapplying, the only recourse for individuals who want to appeal a final OFAC denial of a specific license is run to the courts and attempt to have the administrative decision designated as arbitrary and capricious. Due to the unique powers that the executive branch wields in the sphere of foreign policy and "given the deference that U.S. courts afford to

²² Exec. Order No. 13660, 79. Fed Reg. 46 (Mar. 10, 2014) https://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo.pdf.

²³ *Id.*

²⁴ *Empresa Cubana Exportadora de Alimentos y Productos Varios v. U.S. Dep't of Treasury*, 638 F.3d 794, 798 (D.C. Cir. 2011).

²⁵ The Department of the Treasury, *Terrorism and Financial Intelligence Office of Foreign Assets Control Mission*, <https://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx>.

government agencies charged with making decisions that affect national security, it seems relatively unlikely that a legal challenge to OFAC's licensing decision would succeed.”²⁶

VI. RUSSIAN REGULATIONS

Once an investor makes the determination that their transaction is OFAC compliant by fitting within a general or specific license, the investor must ensure that its transaction is compliant with the laws and regulations of the Russian Federation. Russia is known for its vibrant oil and gas, defense, and financial sectors. All of these industries have special regulations which savvy investors should know about.

a. OIL AND GAS

Article 72 of the Constitution of the Russian Federation specifies that the Russian government and people jointly control the subsoil. This in practice means that the Russian government owns all of the subsoil which is then leased out to the public.

Article 72

1. The joint jurisdiction of the Russian Federation and the subjects of the Russian Federation includes:

[...]

c. issues of possession, use and disposal of land, subsoil, water and other natural resources²⁷

²⁶ Counterterrorism and Humanitarian Engagement Project, *OFAC Licensing*, <http://blogs.harvard.edu/cheproject/files/2012/10/CHE-Project-OFAC-Licensing.pdf>.

²⁷ The Constitution of the Russian Federation, *Chapter 3. The Federal Structure*, <http://www.constitution.ru/en/10003000-04.htm>.

While the Russian subsoil can only be owned by the government of the Russian Federation, the government entity which regulates the subsoil, Rosendra, can issue licenses to exercise exclusive mineral rights within a particular area.²⁸ Such activities include “geological surveys, exploration and mining, construction and operation of underground structure” and collection of “mineralogical or other geological materials.”²⁹ It is important to note, however, that if a company operates in oil and gas fields that have extraordinarily large proven reserves, the lands can be classified as areas of federal significance. If the lands are classified as an area of federal significance, then the company which holds the oil and gas lease are subject to regulation as a strategic company. This means that they are more highly regulated than those with smaller proven reserves. To be classified as an area of federal significance, an oil and gas field must have, “gas reserves from 50 billion cubic, recoverable oil reserves from 70 million tons” or be located in “areas of internal sea waters, territorial sea, and the continental shelf of the Russian Federation.”³⁰

The designation as a strategic company matters to foreign investors seeking invest because they need to comply with the Strategic Investment Law.³¹ Transactions which involve a strategic oil and gas company must first concern a threshold level of ownership before they need to be blessed by the Government Commission on the Monitoring of Foreign Investment with approval. The thresholds are below.

Acquisition of greater than or equal to 25%, including appointment of more than 25% of the board of directors or management board, in a company engaged in

²⁸ Evgeny Gubin & Alexander Molotnikov, *Russian Business Law*, 225-226 (2016).

²⁹ *Id* at 227.

³⁰ *Id* at 228.

³¹ *Id* at 299.

geological survey, or exploration and development of a subsoil area of federal significance

Acquisition of any subsequent stake in a company engaged in a geological survey, or exploration and development of a subsoil area of federal significance, if the given foreign investor or group already control more than 25% but less than 75% in the target³²

An application for preliminary approval must be sent to the Federal Antimonopoly Service [“FAS”] who determines if the approval of the Government Commission on the Monitoring of Foreign Investment is required.³³ If the FAS determines approval is required, it coordinates with the FSB and the Ministry of Defense to make a recommendation to the Commission. Upon reviewing an application, the Commission may approve the transaction, approve it subject to conditions and obligations, or deny it.

An exception to the Strategic Investment Law approval process for oil and gas companies which operate in areas of federal significance exists for “transactions with respect to a company engaged in geological survey or exploration and development of a subsoil area of federal significance, if prior to the consummation of the transaction, the foreign investor had the right to directly or indirectly control more than 75 percent of the total number of votes attributable to the shares/participation interest of the company.”³⁴ So effectively, if a foreign investor already owns 75% of an oil and gas company which operates in an area of federal significance, then it does not need further approval to acquire more control of the company.

b. DEFENSE

³² *Id* at 300.

³³ *Id* at 301.

³⁴ *Id*.

Almost any company related to warfare or the waging thereof is broadly deemed a strategic company in Russia, and foreign ownership is subject to the Strategic Investment Law. A list of what types of military-industrial companies which would be deemed a strategic company is below:

Licensed use of agents of infection, unless related to food production;

[...]

Use of nuclear material and/or radioactive substances for R&D purposes;

[...]

Development of weapons and military equipment;

Manufacturing of weapons and military equipment (except for trading cold steel, non-military and duty weapons, and shells for non-military and duty weapons);

Repairing of weapons and military equipment;

Disposal of weapons and military equipment;

Trading of weapons and military equipment;

Manufacturing weapons and the main parts of firearms;

Manufacturing bullets and their components (except for trading cold steel, non-military and duty weapons, and shells for non-military and duty weapons);

Trading weapons, the main parts of firearms, and bullets (except for trading cold steel, non-military and duty weapons, and shells for non-military and duty weapons);

Development and manufacturing of ammunition and components;

Disposal of ammunition and components;

[...]

Space activities;

Developing aviation equipment, including dual purpose equipment;

Manufacturing aviation equipment, including dual purpose equipment;

Repairing aviation equipment, including dual purpose equipment (except for component repair by civil aviation organizations;

Testing aviation equipment, including dual purpose equipment³⁵

The threshold for a transaction which involves foreign investors which merits scrutiny under the Strategic Investment Law is simultaneously laxer and more encompassing for the defense industry than it is for oil and gas. The relevant statutes are below:

Acquisition of control (more than 50%) including appointment of more than 50% of the board of directors or management board in a Strategic Company;

[...]

Acquisition of the right of ownership, possession or use of property classified as the fixed production assets of a Strategic Company, and the value of which represents greater than or equal to 25% of the balance sheet value of the assets of such a company, as of the last reporting date;

Assumption of managing company functions, or any other transactions leading to the establishment of control with respect to a Strategic Company.³⁶

Unless a transaction qualifies for one of the following exceptions, the transaction must be submitted to the FAS for preliminary approval before it is referred to the Government

³⁵ *Id* at 319.

³⁶ *Id* at 300.

Commission on Monitoring Foreign Investments for final approval or rejection with or without conditions.

A foreign investor directly or indirectly already controls more than 50% of the voting shares in a Strategic Company;

Transactions in which the foreign investor and Strategic Company are under the control of a single person;

Transactions in which the purchaser is an organization under the control of the Russian Federation, or a constituent entity of the Russian Federation, or a citizen of the Russian Federation, if such citizen is a tax resident of the Russian Federation (unless he/she is also a citizen of a foreign state);³⁷

If the transaction falls into one of these exceptions, then it should escape the Government Commission on Monitoring Foreign Investments' scrutiny.

c. BANKING

Companies involved in banking are not designated as strategic companies in the Russian Federation. However, they are subject to special regulation under the Banking Law.³⁸ Foreign banks “may not open branch offices in the Russian Federation.”³⁹ As such, the need to establish local subsidiaries or representative offices.⁴⁰ If a foreigner wants to buy a Russian bank, per Central Bank of Russia Instruction 106-1, they must obtain permission from the Central Bank of

³⁷ *Id* at 301.

³⁸ *Id* at 322.

³⁹ *Id* at 222.

⁴⁰ *Id*.

Russia if they “acquire 10% or more of the shares in a Russian bank” or notify the Central Bank when they acquire between 1% and 10%.⁴¹

Representative offices of foreign banks are interesting insofar that they do “not have the status of a legal entity, but rather [they are the] subdivision of a foreign legal entity in Russia, which represents and protects the foreign company’s interests.”⁴² However, that is all they are allowed to do. These “representative offices are not allowed to perform any banking operations (such as attracting funds on deposit, opening and maintaining bank accounts, lending money etc.)”⁴³ As such, most foreign banks should probably pursue establishing a local subsidiary to conduct normal banking activities or purchase a Russian bank after obtaining permission from the Central Bank of Russia.⁴⁴ Under the subsidiary paradigm, a foreign bank can rest easy knowing that the Central Bank of Russia “may not establish additional requirements for the subsidiary of foreign banks, related to mandatory ratios and minimal charter capital.”⁴⁵ However, they may face additional reporting requirements.⁴⁶

VII. POLITICS AND THE EXXONMOBIL SPECIFIC LICENSE APPLICATION

In an unprecedented move, the Treasury Department commented on the denial of a specific license to transact with a sanctioned entity. The Wall Street Journal reported that in 2015, when Secretary of State Rex Tillerson was ExxonMobil’s chief executive officer, Exxon applied for a specific license to “resume drilling in the Black Sea together with Russian oil

⁴¹ *Id.*

⁴² *Id.* at 22.

⁴³ Norton Rose Fulbright, *Russia*, <http://www.nortonrosefulbright.com/knowledge/technical-resources/banking-reform/supervision-of-international-bank-branches---a-global-analysis/russia/>.

⁴⁴ *Id.*

⁴⁵ *Id.* at 222.

⁴⁶ *Id.*

producer Rosneft,” which is majority owned by the Russian Federation.⁴⁷ The joint venture “would plough an initial \$3.2 billion into exploring the Kara Sea and Black Sea. Rosneft will have a two-thirds stake in the venture, while Exxon would own a third and shoulder the initial exploration costs [and the] total investments could exceed \$500 billion.”⁴⁸ Two days after that story broke, Secretary of the Treasury Steven Mnuchin issued the following one sentence press release:

In consultation with President Donald J. Trump, the Treasury Department will not be issuing waivers to U.S. companies, including Exxon, authorizing drilling prohibited by current Russian sanctions.⁴⁹

The Treasury Department has historically not released much data on why they approve or deny an application for a specific license because of privacy constraints.⁵⁰ This denial is no exception, however it has been reported that Exxon’s specific license application stated that Exxon was “concerned that European competitors who are still operating in Russia [would] gain an advantage in the Black Sea,” and mentioned “a contractual deadline to make an oil discovery there by the end of the year.”⁵¹ So essentially, their argument for why their transaction should have been specifically exempt from the sanctions regime boiled down to business reasons as

⁴⁷Jay Solomon & Bradley Olson, *Exxon Seeks U.S. Waiver to Resume Russia Oil Venture*, The Wall Street Journal, <https://www.wsj.com/articles/exxon-seeks-u-s-waiver-to-work-in-russia-despite-sanctions-1492620677>; The Financial Times, *US Turns Down Exxon Request for Russia Sanctions Waiver*, <https://www.ft.com/content/3218ab92-26c7-11e7-8691-d5f7e0cd0a16>.

⁴⁸ Douglas Busvine & Vladimir Soldatkin, *Exxon, Rosneft Unveil \$500 billion Offshore Venture*, <http://www.reuters.com/article/us-exxon-rosneft-idUSBRE83H0UE20120418>.

⁴⁹⁴⁹ The Department of the Treasury, *Statement from Secretary Mnuchin on OFAC Sanctions*, <https://www.treasury.gov/press-center/press-releases/Pages/sm0052.aspx>.

⁵⁰ Richard Nephew & Colin Rowat, *ExxonMobil Just Challenged Trump to Get Serious With Russia Policy* <http://fortune.com/2017/04/30/sanctions-waivers-donald-trump-russia-exxonmobil/>.

⁵¹ Tom DiChristopher, *Treasury Refuses to Give Exxon Mobil Special Waiver to Drill in Sanctioned Russia*, <http://www.cnn.com/2017/04/21/white-house-refuses-to-give-exxonmobil-special-waiver-to-drill-in-sanctioned-russia.html>.

opposed to “humanitarian or policy grounds,” which does not necessarily lend itself to a sympathetic audience in the government or media.⁵²

What the press has not reported is that the Black Sea joint venture with Rosneft was just a part of a larger deal signed by the Russian state oil company and ExxonMobil. The contract which was “signed [on August 30, 2011] by Rosneft President Eduard Khudaynatov and ExxonMobil Development Company President Neil Duffin in the presence of Russian Prime Minister Vladimir Putin” included an opportunity for Rosneft to gain an equity interest in “exploration and operating ExxonMobil assets in North America, including offshore fields in the Gulf of Mexico.”⁵³

On March 6, 2013, Rosneft did in fact gain a “30 percent interest in 20 deepwater exploration blocks in the Gulf of Mexico held by ExxonMobil, through its “indirect independent subsidiary,” Neftegaz America Shelf LP.⁵⁴ ExxonMobil remained the operator under the agreement, which was supposed to grant Rosneft “access to one of the world's most prolific basins” which has proven to be “a reliable area that has long and successfully yielded profit” in order to balance out the risks associated with drilling in the “Black Sea and Arctic shelves.”⁵⁵

Exactly one year later on March 6, 2014, President Obama signed his first executive order targeting individuals and companies who allegedly helped Russia kick the Ukrainian

⁵² Richard Nephew & Colin Rowat, *ExxonMobil Just Challenged Trump to Get Serious With Russia Policy*, <http://fortune.com/2017/04/30/sanctions-waivers-donald-trump-russia-exxonmobil/>.

⁵³ Rosneft, *Rosneft and ExxonMobil to Join Forces in the Arctic and Black Sea Offshore, Enhance Co-operation Through Technology Sharing and Joint International Projects*, <https://www.rosneft.com/press/releases/item/114495/>.

⁵⁴ ExxonMobil, *Rosneft Subsidiary Acquires Interest in ExxonMobil Gulf of Mexico Exploration Blocks*, <http://news.exxonmobil.com/press-release/rosneft-subsidiary-acquires-interest-exxonmobil-gulf-mexico-exploration-blocks>.

⁵⁵ OE Staff, *Neftegaz America Shelf LP*, Offshore Engineer <http://www.oedigital.com/subsea/item/2962-neftegaz-america-shelf-lp>.

government out of Crimea. On September 12, 2014, the Director of OFAC issued Directive 4 Under Executive Order 13662 which prohibits

[...] the provision, exportation, or reexportation, directly or indirectly, of goods, services (except for financial services), or technology in support of exploration or production for deepwater, Arctic offshore, or shale projects that have the potential to produce oil in the Russian Federation, or in maritime area claimed by the Russian Federation and extending from its territory, and that involve any person determined to be subject to this Directive, its property, or its interests in property.⁵⁶

Rosneft was placed on the Specially Designated Nationals and Blocked Persons List under this directive.⁵⁷

Given the fifty percent rule, ExxonMobil would have been unable to conduct business with Neftegaz to drill in the Gulf of Mexico unless it was granted a specific license to do so.

On December 2, 2016 “Rosneft and ExxonMobil have decided not to proceed with joint development of oil blocks in the Gulf of Mexico due to ‘lack of prospects.’”⁵⁸ A few days later on December 7, 2016 the Russian government sold an \$11 billion 19.5% stake in Rosneft.⁵⁹

In on March 6, 2017, President Trump “congratulated ExxonMobil Corporation on its ambitious \$20 billion investment program that is creating more than 45,000 construction and manufacturing jobs in the United States Gulf Coast region.” This sort of heavy investment in the

⁵⁶ Office of Foreign Assets Control, *Directive 4 Under Executive Order 13662*, https://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13662_directive4.pdf.

⁵⁷ Office of Foreign Assets Control, *Sanctions List Search*, <https://sanctionssearch.ofac.treas.gov/Details.aspx?id=6143>.

⁵⁸ Christian Lowe, *Russia's Rosneft, Exxon Drop Plans for Gulf of Mexico Oil Development: Ifax*, Reuters, <http://www.reuters.com/article/us-russia-rosneft-exxon-mobil-idUSKBN13R1NT>.

⁵⁹ Elena Mazneva & Ilya Arkhipov, *Russia Sells \$11 Billion Stake in Rosneft to Glencore, Qatar*, Bloomberg, <https://www.bloomberg.com/news/articles/2016-12-07/glencore-qatar-fund-buy-russia-s-rosneft-stake-for-11-billion>; Dmitry Zhdannikov & Peter Graff, *How Russia Sold its Oil Jewel: Without Saying Who Bought It*, Reuters, <http://www.reuters.com/article/us-russia-rosneft-privatisation-insight-idUSKBN1582OH>.

Gulf Coast region seems to fly in the face of the Rosneft's contention that there was a lack of prospects in their contemplated deal with ExxonMobil to develop the deepwater exploration blocks. However, the lack of prospects remark may have simply referred to the sanctions which prohibited Rosneft from developing the oil and gas with Exxon in the Gulf. Then on April 21, 2017, the Treasury Department and the White House declared that it had denied ExxonMobil's specific license application to continue drilling with Rosneft after it was leaked that the application was under consideration.

From an outsider looking into the nebulous cloud of sanctions, contract cancellations, press releases, and application denial timing, it would appear that there was some form of higher politics at play in the decision to deny this specific license to drill. This interesting case study would lead a legal realist to suggest that, at a minimum, if a corporation is seeking an OFAC specific license in a sanctioned country, like Russia, then the corporation should hope that its application does not get leaked to the press and become a political football, lest it punted out of OFAC at the behest of the White House.

Another way to potentially look at this interesting insight into how these determinations are made is that the specific license application decisions are made in a manner which sometimes involves deep discussions at the highest levels of government. Perhaps ExxonMobil just did not provide the government with the right motivation, and it should have attempted to utilize a humanitarian or geostrategic rationale to give the Treasury Department in consultation with the Department of State, and the White House a solid reason to award the specific license.

ExxonMobil should have primarily argued that the oil companies located in the European Union are already undermining the sanction regime. Thus, it is not in the United States' strategic interest to maintain these artificial barriers to trade with no tangible benefit. ExxonMobil said

while it understands OFAC's decision to reject its specific license application, it applied in the first place "to enable [Exxon] to meet its contractual obligations under a joint venture agreement in Russia, where competitor companies are authorized to undertake such work under European sanctions."⁶⁰ While a businessman can be very sympathetic to this argument, it does not even mention the leverage benefits of keeping a major segment of the Russian economy, their energy sector, reliant upon American technology, equipment, and expertise. However, given the timing of the Treasury Department's press release, and the emergence of the Third Red Scare in the United States, it is doubtful that Exxon could have made any argument to get its application approved. It appears that the government may have been more concerned with the optics of approving this license than the strategic policy implications of the decision.

⁶⁰ Graham Kates, *Trump Administration Denies Exxon a Waiver for Russia Project*, <http://www.cbsnews.com/news/exxon-russian-sanctions-oil-rosneft-black-sea/>.