

# Financial Restructuring Alert

## Reflections on Restructurings: Impacts and Experiences of Unprecedented Sanctions Regimes

January 10, 2023

Since Russia's invasion of Ukraine in February 2022, we have seen an extraordinary range of sanctions and export controls restrictions introduced by tens of countries worldwide. The current sanctions imposed on Russia by the United States (US), the United Kingdom (UK) and the European Union (EU) are unprecedented in both their scope and application, while Russia's countersanction responses are similarly far-reaching and unprecedented. These sanctions restrictions, which vary by jurisdiction and continue to evolve, are impacting (and will continue to impact) restructuring transactions which we have been involved in, and navigating the resulting transactional complexities will be critical for the foreseeable future – particularly as we anticipate that further sanctions and export controls will be introduced as the war continues.

Over the last ten months, our financial restructuring and sanctions teams have worked together to navigate the intricacies and impacts of the sanctions regimes, and, while the considerations will be unique (and numerous) in each situation, our experience to date provides valuable and practical insights.

### Scope of Coverage

A central consideration in those cases has been the US blocking sanctions, imposed when the US Department of the Treasury's Office of Foreign Assets Control (OFAC), the primary US sanctions regulator, designates an individual or entity as a "Specially Designated National and Blocked Person" (SDN). Under OFAC's 50 per cent rule, all entities 50 per cent or more owned, directly or indirectly, individually or in the aggregate, by one or more SDNs or blocked persons are also blocked. US persons (as defined under US sanctions) may not engage – directly or indirectly – in any transactions or dealings with (including trading in) any shares or bonds held by blocked persons. If, for example, a US person holds shares in, or bonds issued by, a company that is blocked, the bonds or shares held by that US person must be similarly blocked and OFAC must be notified within 10 days of those holdings that the securities are blocked. Additionally, where US sanctions apply and a blocked person is a debt or equity holder (or the debt holder holds through an SDN custodian), the ability to amend the underlying finance or governance documents may require an OFAC licence (both consensually and through a recognised restructuring process, such as a scheme of arrangement).

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The EU and the UK have introduced similar asset freezes and, depending on the particular transaction, UK and EU licencing may also be required.

But sanctions considerations go beyond the asset freezes. US sanctions jurisdiction in particular is extremely broad and can apply to transactions, activities or dealings outside the United States among non-US companies without US assets or subsidiaries. As examples, if the relevant debt is US-dollar denominated, the debt or equity is held through the Depository Trust Company (DTC) and/or US trustees, custodians or intermediaries are involved, US sanctions jurisdiction will apply. In addition, US, EU and UK sanctions prohibitions are intentionally drafted broadly and therefore cover situations where you may not expect sanctions to be implicated, for example, where a non-Russian parent company seeks to agree on an amend and extend transaction with its debt holders but the underlying assets or operations of the group include significant Russian assets or operations, such a transaction may be prohibited by the new investment bans under US and/or UK sanctions, respectively, and, if so, cannot proceed without appropriate licencing.

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### **Trust Restrictions and Associated Issues**

The US, the EU and (as of 16 December 2022) the UK have also implemented services bans. Trustee companies may not be able and/or willing to continue to act as trustees as a result of the services bans which cover, among others, trustee services. Such bans are different than the blocking sanctions as they prohibit US persons from providing any trust services to any person located in Russia (including individuals ordinarily resident in Russia and entities incorporated in Russia) or where the benefit of the services is ultimately received in Russia, EU persons from providing any trust services or any similar legal arrangement where the trustor or beneficiary of such arrangement is a Russian national, resident or entity and UK persons from providing trust services to or for the benefit of a person connected with Russia from 16 December 2022. The breadth of the EU wording can have far-reaching applications, and we are seeing corporate trustees taking highly conservative approaches to sanctions, with many adopting a zero-risk posture and only taking actions where licences are in place. Given the recent introduction of the UK trust services ban which builds upon the US and EU services bans, we expect this latest development to further reinforce the conservative approach of corporate trustees to situations involving Russia.

### **Blocking of Russian National Securities Depository**

In addition, EU sanctions currently extend to the Russian National Securities Depository (NSD), which is the local depository system used by Russian bondholders. In accordance with EU sanctions, all funds and economic resources belonging to, owned, held or controlled by the NSD must be frozen and no funds or economic resources can be made available, directly or indirectly, to or for the benefit of the NSD. Therefore, the sanctioning of the NSD means that the clearing systems are unable to make payments to the NSD (among other things). As a result, monies paid by bond issuers to the international clearing systems which are due to be passed on to the NSD – and the bondholders holding through the NSD – are currently being withheld by the clearing systems. In response, recently introduced Russian legislation requires Russian bond issuers to make direct payments to NSD bondholders; however, that legislation does not abrogate those issuers' contractual obligations to make payments

through the clearing systems in the ordinary course, illustrating the prevailing tension between Western sanctions and Russian countersanctions.

## Implications for Restructurings

What are the practical implications of these restrictions for restructurings? Obtaining specific licences from each jurisdiction adds uncertainty to the timing and ability to complete the restructuring. Moreover, each of the EU and UK regimes has limited grounds under which licences can be sought to allow persons to engage in conduct that would otherwise be prohibited. Given the significant penalties – and, in many cases, strict liability – for breaches, it is increasingly necessary to apply for licences where an SDN or blocked person under US sanctions, or designated person (DP) under European or UK legislation, is invested in a company's debt or equity or may be otherwise directly or indirectly involved in the restructuring.

Helpfully, where its involvement is necessary, the English courts have been pragmatic in their approach to licence-related issues. On application from the Petropavlovsk administrators, the judge gave leave to enter into a sale transaction in advance of the administrators seeking a licence, recognising the urgent need to implement the sale. The court was also comfortable approving the Nostrum scheme of arrangement in advance of all relevant licences being obtained. The court provided that implementation of the scheme (being a debt-for-debt and debt-for-equity swap) was unable to proceed without all necessary sanctions licences in place. Notwithstanding the practical approach of the judiciary, the need to seek, and the delay in issuing, licences has impacted restructuring timetables.

As the war in Ukraine continues, we expect further waves of sanctions and export controls to be implemented and for the US, UK and European regulators to designate further persons as blocked persons and designated persons and to tighten the sanctions and export controls against Russian nationals and companies generally. Restructuring advisers and investors will need to continue to adapt to that evolving landscape, which is posing a number of unique and unprecedented challenges to established restructuring practices and solutions.

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