

Risks and Rewards of Corporate Activism: Russia and Beyond

May 3, 2022

Presenters:

Antonia Tzinova

202.419.2661

antonia.tzinova@hklaw.com

Jonathan Wolcott

703.720.8073

jonathan.wolcott@hklaw.com

Valarie Ney

703.720.8054

valarie.ney@hklaw.com

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**What's Required: Sanctions, Compliance,
etc.**

With respect to Russian War on Ukraine

Big Picture: Economic Sanctions

Worldwide Cooperation

- Unprecedented coordination
 - **U.S., EU, UK, Australia, New Zealand, Canada** and other Allies: synchronized sanctions
 - **Germany** stopped certification of Nord Stream 2
 - Countries are sending financial and military equipment support to Ukraine
- Historically neutral countries: **Switzerland, Sweden, Finland, Israel**
- **Turkey** recognized the Russian invasion as “war” under the Montreux Convention
- Two major state-owned **Chinese** banks reported to refuse to support transactions with Russia

U.S. Sanctions

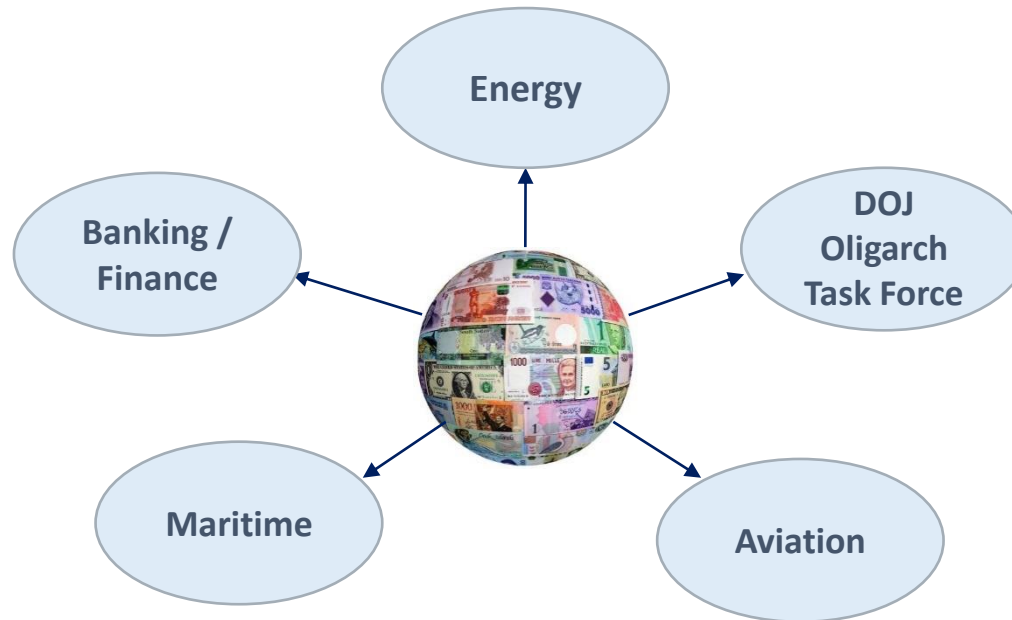
- **Banking:** designations / correspondent and payable through accounts
- **SWIFT:** cut off access
- **Russia foreign reserves**
- **Sovereign debt:** no new debt / equity
- **Hard currency:** no U.S. dollar banknotes to Russia
- **Senior Russian officials / elites / family members:** designations; DOJ Task Force on oligarchs
- **Energy:** Russian oil and gas
- **Luxury Goods:** No exports to Russia, Belarus, designated oligarchs
- **Donetsk and Luhansk breakaway regions:** near total embargo

U.S. Sanctions So Far

President Biden: sanctions are designed to "impose severe costs on the Russian economy" to "maximize the long-term impact on Russia" and minimize the impact on the United States and its allies

- targeting the core infrastructure of the Russian financial system, including sanctions against Russia's largest financial institutions
- restricting the ability of the government of the Russian Federation to raise capital, and
- cutting it off from access to critical technologies
- Feb. 22, 2022 – prohibitions on dealing with the two breakaway regions in Donbas (Donetsk and Luhansk)
- Feb. 24, 2022 – designations of Russian financial institutions, Russian elites, Russian state-owned enterprises and several of Russia's critical industrial sectors
- Feb. 24 – BIS rule on high tech exports
- Mar. 1 – DOJ Task Force on Oligarchs
- Mar. 8 – ban on import of Russian oil & gas
- Mar. 11 – fish / luxury goods / U.S. dollar denominated banknotes / alcohol / non-industrial diamonds
- Mar. 11 – BIS luxury goods (includes certain vehicles)
- Apr. 8 – President signs bill suspending normal trade relations with Russia & Belarus (revokes MFN status / higher duties on imported items)

Effect on Certain Industry Sectors



Banking / Currency Related Sanctions



- **Complex and Varied Sanctions on Russian Financial Institutions**
 - Full blocking sanctions on Russia’s largest financial institution, Sberbank, and Russia’s largest private bank, Alfa Bank.
 - No new investment in Russia / sectoral sanctions limiting investment and new debt
 - Central Bank of Russia, Ministry of Finance, National Wealth Fund (~\$650 billion)
 - Asset Freezing / SDN Designation of Russian banks
 - SWIFT restrictions on certain banks
- **No payments in U.S. denominated banknotes**
- **General Licenses**
- **Wind-down Transactions**
- **Practical effect and “derisking” by U.S. and other financial institutions**
 - Pause on Russian activities – “abundance of caution” approach as there is a lot of risk of getting it wrong just once
 - May refuse to open, issue, confirm or advise letters of credit directly or indirectly connected with Russian parties and Russia-related transactions

Energy

- **Designations:**
 - Nord Stream 2 AG and Matthias Warnig as SDNs, with a short wind-down period ending March 2, 2022, as outlined in [General License 4](#)
 - Designation of five Russian-flagged oil tankers and container ships owned by PSB as SDNs
- **Ban on imports of Russian-origin crude oil, petroleum, petroleum, fuels, oils and products of their distillation, liquefied natural gas, coal, coal products**
 - to include contribution of funds, assets, loans or other extension of credit for a range of activities in or related to Russia including the transport of such energy products
 - does not prohibit transactions such as the unwinding of contracts or other business-related activities by U.S. persons to comply with its import ban.
- **Ban on "new" U.S. investment in the Russian energy sector** – state-owned enterprises, such as Gazprom and Transneft, prohibited from issuing new debt in the U.S. – affects ability to invest in the energy sector
- **General Licenses**
 - [GL 8B](#) authorizes U.S. persons to process payments involving energy-related transactions through certain sanctioned Russian financial institutions through June 24
 - [GL 16](#) authorizes the wind-down of now prohibited activities through April 22
 - EO does not prohibit U.S. persons from engaging in transactions to sell or redirect shipments that were laden on or after March 8 and previously destined for the United States.
- **US Domestic Oil Supply**
 - Role that the U.S. Strategic Petroleum Reserve (SPR), the world's largest supply of emergency crude oil: federally owned; designed to hold up to [714 million barrels of crude oil](#) in underground salt caverns at four storage sites along the Gulf of Mexico.
 - Shifts in the oil markets and trading patterns could also raise tanker availability and Jones Act concerns
 - In 2011, the [Jones Act was waived](#) during a crisis in Libya to allow foreign tankers to ship oil from the U.S.

SDNs | DOJ Oligarch Task Force

- **Senior Russian Officials, Russian Elite and Family Members**
 - President Putin and his two daughters
 - Minister of Foreign Affairs Sergei Lavrov, his wife, and daughter
 - members of Russia's Security Council and the Duma: high-level government officials, senior officials of some of the designated banks and their family members
 - family members of individuals in Putin's inner circle
- **DOJ Task Force on Oligarchs** – intersection of OFAC jurisdiction and due process
 - The Task Force will include agents and analysts from numerous law enforcement agencies: DOJ, FBI, U.S. Marshals Service, U.S. Secret Service, Department of Homeland Security–Homeland Security Investigations, IRS–Criminal Investigation, U.S. Postal Inspection Service
 - authorized to investigate and prosecute any criminal offense related to its mission, including conspiracy to defraud the United States **by interfering in and obstructing lawful government functions**; money laundering; false statements to a financial institution; **bank fraud**; and various tax offenses. The maximum penalty under several of these authorities is 20 years in prison
- Some overlap between U.S., EU, UK and other jurisdictions but not identical
- 50% ownership rule



Export Controls

Tighter controls on exports, reexports, and transfers (in-country) for U.S. products destined for Russia.

Items listed on the Commerce Control List

- Policy of denial
- Restrictions on use of license exceptions

Military end-use / military end-user controls to Russian government and state-owned entities

- A near-total embargo.

Foreign Direct Product Rules specific to Russia

- Partner countries
- Encourages adoption of similar rules by other countries

Luxury Goods

- Items subject to the EAR
- New Supplement 5
- Parallel OFAC sanctions – includes foreign made goods

Aviation



- Cannot re-export U.S. origin goods (aircraft manufactured in the U.S. or incorporating U.S.-origin parts e.g., engines)
- U.S. Dep't Commerce (BIS) Actively Pursuing Violators
 - March 18 - publicly identified commercial and private aircraft (100+) that flew to Russia in apparent violation of the EAR
 - April 7 – temporarily denied export privileges of Aeroflot, Azur Air, and UTair
- Bans on entering U.S., EU, and UK airspace
- Russian Response – nationalizing aircraft

Maritime

To further address the unusual and extraordinary threat to the national security, foreign policy, and economy of the United States described in E.O. 14024, and in consultation with the Secretary of State, I hereby determine that section 1(a)(i) shall apply to the aerospace, electronics, and marine sectors of the Russian Federation economy. Any person that I or my

- The U.S., UK, and EU: measures on various aspects of shipping, banking, and trade, all of which should be vetted when booking cargo and fixing vessels
 - Imports of Russian gas/oil/coal – wind-down period
 - Imports of Russian seafood
 - Some maritime-related technology (navigation)
- The U.S. has designated several cargo vessels as SDNs given their connections to Russian entities, and more could follow.
- Risk relates to transactions involving SDNs and certain Russian banks and their foreign subsidiaries

Sovcomflot hit by US financial restrictions as Ukraine crisis escalates

US entities are banned from dealing with new debts or shares to be issued by Russia's largest shipping firm

24 Feb 2022 | NEWS

International Trade

Russian Tankers Going Dark Raises Flags on Sanctions Evasion (1)

Russian Countermeasures*

- Export ban on a number of products – to prevent a "flight of goods"
 - telecommunications, medical, automotive, agricultural and electrical equipment, timber products
 - affects subsidiaries of Western companies in Russia – prevented from selling stock to customers in the EU or the U.S.; liquidity problem
- Quasi-expropriation of foreign investors – placement under external management of Russian companies 25%-owned / controlled by foreign nationals of “unfriendly states”
 - a balance sheet value of 1 billion rubles (approx. 7 million euros) and at least 100 employees
 - effectively ceased managing the company's business or actions that may lead to an unjustified cessation of the company's activities, its liquidation or insolvency
 - assets transferred to a newly founded company and the original company liquidated
 - suspension of activities in Russia by a foreign investor (e.g., closing production) treated as intentional insolvency and insolvency proceedings commenced (up to 7 years imprisonment)
- Mandatory Sale of Currency Proceeds
 - Russian companies must sell 80% of the foreign currency proceeds received from foreign trade within 3 business days
 - Procedure to be established by the Bank of Russia
- Transactions with Real Estate
 - Permit required for certain real estate transactions between Russian residents and persons related to “unfriendly states”
- Foreign Currency and RUB Loans with Non-Residents
 - Permit required to extend a loan in foreign currency to non-residents (doesn't apply to servicing an existing loan)
 - Repayment of loans to persons related to “unfriendly states” prohibited in amounts exceeding RUB 10 million (~\$95k) per month; funds may be credited by Russian residents to Russian bank accounts of the foreign person in rubles
 - permit required to extend RUB loans to persons related to “unfriendly states”
- Sales of Securities / Ban on Dividends and Other Payments under Securities / Delisting from Foreign Exchanges
 - brokers prohibited from performing sales of securities at the instruction of foreign persons; many Russian banks suspended all payments of dividends, even if not prohibited
 - Delisting of Russian publicly traded companies from foreign exchanges by May 5 – convert depository receipts into ordinary stock
- Cash Export
 - export from Russia of foreign currency in cash in foreign currency in the amount exceeding \$10,000
- Payment in Rubles for Oil and Gas Exports to “unfriendly states” (open ruble accounts with Gazprombank)
 - Gas deliveries to Poland and Bulgaria stopped on April 27, 2022

* Based on a Noerr trade alert, <https://www.noerr.com/en/newsroom/news/russian-countermeasures-getting-more-comprehensive>.

Key Takeaways: where to start to assess potential risks?

- » **Assess potential exposure: What are your clients' touchpoints in Russia or with Russian entities?**
 - Russian operations, employees or offices?
 - Import or export products, software, or technology?
 - Sell to third parties that resell or distribute in Russia?
 - Components incorporated into partner products sold in Russia?
 - Accept donations or funding from Russian individuals or entities?

- » **Conduct robust screening and diligence commensurate with client profile.**
 - Vet direct relationships and ownership and control analysis
 - Review frequency and scope of screening (including if conducted by third-party vendors)

- » **Update / reassess contracts and agreements with Russian counterparties or resellers or distributors selling into Russian market, to determine adequacy of key provisions.**

- » **Whether exposure to Russia or not, a good time to review / refine compliance program.**

**What's Optional (or is it?):
Corporate Activism or "Self Sanctioning":
Russia/Ukraine and Beyond**

Corporate Activism or “Self Sanctioning”

- A. Historical Role of the Corporation
 - Fiduciary Duties owed to Shareholder only
 - Maximizing Shareholder Value

- B. Shareholder/Investor Demands and Pressures
 - Principles for Responsible Investment - Signatories
 - ESG Shareholder Proposals
 - Business Roundtable 2019 Redefinition: Promote “An Economy That Serves All Americans”
 - Public and Other Calls for Corporate Activism

Corporate Activism or “Self Sanctioning”

c. Considerations under Delaware Law

– Principal Fiduciary Duties - Care and Loyalty

– Duty of Care

- Consideration of “all material information reasonably available”
- “Material” = “relevant and of a magnitude to be important to directors in carrying out their fiduciary duty of care in decision making”
- Duty to consider ESG factors if “material” and substantial director latitude in determining materiality
- Directors entitled to rely on information from Corporation’s officers, employees, Board committees
- Directors can’t consciously disregard a known material risk; but are only liable for breach of duty of care if “grossly negligent”

Corporate Activism or “Self Sanctioning”

- Duty of Loyalty
 - No material self-interest, must be independent in making decisions
 - Duty of loyalty unlikely implicated in ESG determinations
- Business Judgment Rule (BJR)
 - Deference, absent breach of duty, for decisions that are related to “any rational business purpose”

Corporate Activism or “Self Sanctioning”

D. Corporate Activism and Litigation Risks

– Fiduciary Duty Claims:

- Director Exculpation Provisions in COIs - no duty of care breach if acting in good faith
- BJR Presumption - burden on plaintiffs
- Duty of Care breaches = derivative; assuming fiduciary duty compliance, Board may not pursue
- If compliance implicated - duty is good faith efforts to implement reporting and compliance programs

Corporate Activism or “Self Sanctioning”

– Disclosure/10b-5 Claims:

- Potentially larger risk - was disclosure adequate and timely?
- Should corporation have foreseen and disclosed risks to shareholders (Russia, Disney)?
- Risk Factors - adequacy; may vary based on particular ESG issues and materiality to business - not only should have disclosed, but disclosed more specifically
- Disclosure brings its own risks - plaintiff second guessing if events turn out differently

Corporate Activism or “Self Sanctioning”

E. Other Risk/Reward and Practical Considerations

- Fiduciary/BJR defenses and effectiveness may be bolstered by other corporations actions
 - Circular/domino effect - both optics and business (if everyone’s pulling out of Russia, who’s left to do business with, get supplies and services from, sell to?)
 - Self-sanctioning more effective when all are doing it
- Scale and business may matter - e.g, Russia is different calculus for car manufacturers than oil companies; different calculus for direct health care services than entertainment
- Slippery Slope - if Russia, why not smaller African countries; if LGBTQ elementary education, why not womens’ reproductive rights education?

Corporate Activism or “Self Sanctioning”

- Unintended consequences - more harm than good; reactions and actions of opposed party(ies)
- End scenario must be strongly considered - what’s the criteria under which the goal of the corporate activism has been met? When and under what circumstances do companies re-start Russian business
- Individual corporation/Board view on proper role - are corporations the new diplomats and politicians?
- Role of GC: Compliance/legal risks for sure. Also strategy – if / then scenarios

Corporate Activism or “Self Sanctioning”

- Employees:

- Often the major force within a corporation for stances/actions on ESG issues (e.g., Disney)
- Also the population often conducting activities supporting ESG positions and causes (e.g., Russia/Ukraine related activities)
- Reflective of the changing role of the corporation - major constituency other than shareholders

Antonia Tzinova



Antonia I. Tzinova is a partner in Holland & Knight's Washington, D.C., office. Ms. Tzinova practices in the areas of international trade, foreign direct investment and industrial security. She advises on defense and high-technology exports; U.S. trade embargoes and economic sanctions; and customs matters. She regularly represents clients before the Committee on Foreign Investment in the United States (CFIUS) and advises on measures to mitigate Foreign Ownership, Control, or Influence (FOCI) in cross border mergers and acquisitions of U.S. government and defense contractors. She counsels foreign investors on structuring investments in the defense, high-tech and critical infrastructure sectors of the U.S. economy.

[Full bio available here.](#)

<p>Antonia Tzinova Partner 202.419.2661 Antonia.Tzinova@hklaw.com Washington, D.C.</p>	<p>Practice</p> <ul style="list-style-type: none">• U.S. Export Controls and Sanctions Laws• CFIUS and Industrial Security• International Trade• Mergers and Acquisitions	<p>Education</p> <ul style="list-style-type: none">• The George Washington University Law School, J.D., with honors• Sofia University Law School (Bulgaria), Jurist and Masters in Law (J.D./LL.M. equivalent), International Law and International Affairs	<p>Bar Admission</p> <ul style="list-style-type: none">• District of Columbia• Maryland
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Jonathan Wolcott



Jonathan F. Wolcott is a corporate services attorney in Holland & Knight's Tysons office and practices in the areas of mergers and acquisitions, securities and corporate law. He represents public and private companies and their boards, investment banks, private equity funds and individual investors in a variety of transactional, securities law compliance and capital raising activities.

[Full bio available here.](#)

<p>Jonathan Wolcott Partner 703.720.8073 Jonathan.Wolcott@hklaw.com Tysons, VA</p>	<p>Practice</p> <ul style="list-style-type: none">• Public Companies and Securities• Mergers and Acquisitions• Corporate Governance• National Security, Defense and Intelligence	<p>Education</p> <ul style="list-style-type: none">• University of Virginia School of Law, J.D.• Amherst College, B.A., <i>magna cum laude</i>	<p>Bar Admission</p> <ul style="list-style-type: none">• District of Columbia• Virginia
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Valarie Ney



Valarie Ney is an attorney in Holland & Knight's Tysons office. Ms. Ney's mergers and acquisitions experience involves the full range of M&A transactions, including public company mergers and spin-offs, private company acquisitions and dispositions, auctions, joint ventures, licensing transactions, going private transactions, special committee representations and tender offers. She has advised clients in a number of cross-border transactions as well as on a variety of corporate, securities and corporate governance matters. As part of her governance practice, Ms. Ney regularly advises clients on disclosure, compliance and governance matters arising out of U.S. Securities and Exchange Commission (SEC) regulations, stock exchange rules and corporate laws. Her practice involves several industries, including government contracting, pharmaceutical, healthcare, energy, technology and manufacturing.

[Full bio available here.](#)

<p>Valarie Ney Partner 703.720.8054 Valarie.Ney@hklaw.com Tysons, VA</p>	<p>Practice</p> <ul style="list-style-type: none">• Public Companies and Securities• Mergers and Acquisitions• Corporate Governance• International and Cross-Border Transactions	<p>Education</p> <ul style="list-style-type: none">• University of Virginia School of Law, J.D.• Bowdoin College, B.A.	<p>Bar Admission</p> <ul style="list-style-type: none">• District of Columbia• New York• Virginia
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