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Business as Usual: Sanctions Circumvention by Western Firms in Crimea^{*}

Maria Shagina

Abstract: *Despite the ongoing sanctions regime, many foreign companies continue their operations in Crimea without any legal repercussions. The purpose of this article is to highlight the common patterns of sanctions circumvention used by Western firms in order to keep their businesses in Crimea. By juxtaposing the companies' justifications and their behavior, this article assesses the companies' activities vis-à-vis the sanctions' legal framework. The article reveals the weaknesses within the sanctions regime and makes policy recommendations for the enhancement of the effectiveness of sanctions.*

Keywords: sanctions, Crimea, Ukraine, Russia, compliance

Introduction

In 2014, the United States and the European Union imposed sanctions on Russia in response to its annexation of Crimea and hybrid war in Eastern Ukraine. March 2018 marked four years since Russia's violation of fundamental principles of international law. Reaffirming its Ukraine policy, in July 2018 the United States issued the Crimea Declaration stating that the US "rejects Russia's attempted annexation of Crimea and pledges to maintain this policy

^{*} This research was financially supported by the Japan Society for the Promotion of Science. Special thanks also go to Professor Mika Hayashi, Kobe University, who helped me during the writing of this article.

until Ukraine's territorial integrity is restored.”¹ The European Union also recently reiterated its position that it does not recognize Russia's illegal annexation and it continues to condemn Russia's violation of international law.² As part of the US and EU non-recognition policies, the Crimea sanctions, which ban trade, investment, finance, and shipping services, remain in place.

Due to the comprehensive sanctions regime, it is now mostly Russian companies that are actively operating in Crimea. The majority of investment in Crimea comes from the Russian budget and is directed to infrastructure, tourism, and agriculture.³ In 2014–2017, Russian federal spending on Crimea amounted to 350 billion rubles (\$5.2 billion).⁴ Another 300 billion rubles (\$4.4 billion) from the budget were spent on the construction of the Kerch Bridge that physically connects Crimea with the Russian mainland.⁵ Both the US and the EU condemned those involved in the building of the bridge, stating that it represents “an attempt by Russia to solidify its unlawful seizure and its occupation of Crimea.”⁶

However, it is not only Russian businesses who are eager to stay in Crimea. According to Sergey Aksenov, Crimea's self-proclaimed prime minister, nearly 3,000 foreign firms, including

¹ US Department of State, “Crimea Declaration,” *US Department of State official website*, 25 July 2018, <https://www.state.gov/secretary/remarks/2018/07/284508.htm>. All URLs cited in this article were accessible on 31 August 2018.

² European Council, “Ukraine: EU adds six entities involved in the construction of the Kerch Bridge connecting the illegally annexed Crimea to Russia to sanctions list,” *European Council official website*, 31 July 2018, <https://www.consilium.europa.eu/en/press/press-releases/2018/07/31/ukraine-eu-adds-six-entities-involved-in-the-construction-of-the-kerch-bridge-connecting-the-illegally-annexed-crimea-to-russia-to-sanctions-list/>.

³ “Kto investiruet v Krym,” *Vedomosti*, 16 March 2018, <https://www.vedomosti.ru/economics/articles/2018/03/16/753933-investiruet-krim>.

⁴ *Ibid.*

⁵ “Kak stroiat Krymskii most,” *Vedomosti*, 10 June 2018, <https://www.vedomosti.ru/realty/galleries/2016/06/10/644809-kak-stroyat-kerchenskii-most>.

⁶ US Department of State, “The Opening of the Kerch Bridge in Crimea,” *US Department of State official website*, 15 May 2018, <https://www.state.gov/r/pa/prs/ps/2018/05/282116.htm>.

European companies, are currently working on the peninsula.⁷ Aksenov has encouraged foreign companies to invest in Crimea, pointing out that there are ways to circumvent sanctions and to conceal companies' identities.⁸ Indeed, despite the sanctions, European and American companies such as Visa, Mastercard, Volkswagen, Auchan, DHL, Adidas, Metro Cash&Carry and others continue operating in Crimea.⁹ In spite of the prohibitions, in 2015 the number of EU-registered ships calling at sanctioned Crimean ports grew by 23.4%—89 calls more than in 2014. Ships with links to Germany, Italy, Greece, and Bulgaria were the most frequent ones.¹⁰

In 2017, the Siemens scandal offered a vivid illustration of such sanctions breaches, highlighting problems with compliance and enforcement. In summer 2015, it was alleged that Siemens, a German engineering corporation, had supplied gas turbines for the construction of a power plant in Crimea. Siemens representatives refuted this allegation, stating that the company “has not delivered turbines to Crimea and complies with all export control restrictions.”¹¹ They asserted that the supplied turbines had been destined for a power plant in Russia's Taman under their contract with a Russian firm, Technopromexport. As more light was shed on the deal, more questions appeared about Siemens' due diligence process.¹² Eventually ceding to international pressure, in July 2017

⁷ “Nearly 3,000 Foreign Firms Working in Crimea Despite Sanctions,” *RT*, 30 March 2018, <https://www.rt.com/business/422790-sanctioned-crimea-thousands-foreign-investors/>.

⁸ “Aksenov soobshchil o vozmozhnosti dlia zarubezhnogo biznesa rabotat' v Krymu v obkhod sanktsii,” *Kommersant*, 4 November 2017, <https://www.kommersant.ru/doc/3459822>.

⁹ “Ne smeshite nashi magaziny. Kak obkhodiat sanktsii v Krymu,” *Novaia gazeta*, 31 January 2018, https://www.novayagazeta.ru/articles/2018/01/31/75337-ne-smeshite-nashi-magaziny?utm_source=push.

¹⁰ Lloyd's List, “Out of Sight, Out of Mind. Are Shipping Companies Violating Sanctions in Crimea?” *The Intelligence*, January 2016, 13.

¹¹ Anton Zverev, Anastasia Lyrchikova, and Gleb Stolyarov, “Exclusive: Siemens Turbines Delivered to Crimea Despite Sanctions—Sources,” *Reuters*, 6 July 2016, <https://www.reuters.com/article/us-ukraine-crisis-crimea-power-exclusive-idUSKBN19Q26I>.

¹² Alya Shandra, “How Siemens Chose to Ignore the Obvious. An Investigation into the Crimean Sanctions Break,” *Euromaidan Press*, 24 July 2017,

the company acknowledged that their gas turbines had in fact been transferred to Crimea, but claimed that this had been done without Siemens' knowledge or consent. Siemens emphasized that they prohibited the delivery of the gas turbines to Crimea and that their Russian partners breached "delivery contracts, trust and EU regulations."¹³ Next, Siemens brought lawsuits to the Moscow Arbitration Court to invalidate the transactions and to force these companies to return the gas turbines to their original destination outside Crimea. Predictably, these lawsuits were rejected by the Moscow Arbitration Court.¹⁴

The infamous Siemens case does not appear to have acted as a deterrent to others. Recent reports reveal that there are still a number of foreign companies which fail to conduct thorough due diligence and/or are willing to circumvent sanctions.¹⁵ Shifting the focus from the Siemens case, the main purpose of this article is to examine the loopholes within US/EU sanctions and to analyze how Western firms are exploiting the gaps to avoid or evade sanctions. Consequently, the focus is on Western companies rather than on Russian ones. Russian companies' desire to circumvent sanctions is understandable. "Economic warfare inevitably promotes economic crime"¹⁶: it is not surprising that, in order to adapt to this situation,

<http://euromaidanpress.com/2017/07/24/how-siemens-chose-to-ignore-the-obvious-crimea-turbines/>.

¹³ Official statement regarding turbines to Crimea, *Siemens Press Release*, 21 July 2017, <http://sie.ag/2tPhlge>.

¹⁴ "Arbitration Court Denies Siemens Appeal to Return Gas Turbines Delivered to Crimea," TASS, 14 December 2017, <http://tass.com/economy/980866>; and "Siemens unterliegt in der Krim-Affäre," NZZ, 11. Januar 2018, <https://www.nzz.ch/wirtschaft/siemens-unterliegt-in-der-krim-affaere-ld.1346447>.

¹⁵ See, for example, Alya Shandra, "How Siemens Chose to Ignore the Obvious. An Investigation into the Crimean Sanctions Break," *Euromaidan Press*, 24 July 2017, <http://euromaidanpress.com/2017/07/24/how-siemens-chose-to-ignore-the-obvious-crimea-turbines/>; Tatiana Guchakova and Andrii Klymenko (eds), *"The Gray Zone." Occupied Crimea: Sanctions Violations in 2017. Monitoring Results* (Kyiv: The Black Sea Institute of Strategic Studies, 2018); and Aleksandr Golubov, "Narushteli sanktsii: kak evropeiskie kompanii vedut biznes v Krymu," *Krym.Realii*, 11 July 2018, <https://ru.krymr.com/a/29357169.html>.

¹⁶ Richard Naylor, *Economic Warfare: Sanctions, Embargo Busting, and Their Human Costs* (Boston: Northeast University Press, 2001), 4.

the targeted Russian entities would be willing to engage in sanctions-busting. However, a sanctions-busting scheme usually needs facilitators and enablers in the West—whenever there is a sanctions breach orchestrated by a Russian firm, there is a Western firm at the other end of this transaction. Although Western companies should be under closer scrutiny and show more integrity, the breaching of sanctions compliance still happens. By distinguishing between sanctions avoidance and sanctions evasion, this article provides a legal assessment of Western companies' activities in Crimea.

This article has the following structure. First, it will review the previous studies conducted on this topic from the perspectives of international law and international relations (IR). Second, it will examine the international sanctions regime vis-à-vis Crimea. In particular, the restrictive measures adopted by the US and EU will be discussed and their differences and weaknesses will be analyzed. Third, five sanctions compliance cases involving Western firms will be examined. Juxtaposing companies' justifications and behavior with the legal provisions, the cases will be classified as instances of sanctions avoidance or evasion. The final part will draw conclusions, highlighting the common practices in sanctions circumvention, and will make policy recommendations aimed at improving the effectiveness of the sanctions regime.

Literature Review

The vast majority of the academic literature on sanctions concentrates on their effectiveness. In particular, the scholarship tends to focus on evaluating the effects of a fully-fledged sanctions policy on its target. On the whole, the scholarly view on the effectiveness of sanctions as a foreign policy tool for changing a target's behavior is pessimistic.¹⁷ However, with the arrival of so-

¹⁷ See, for example, Robert A. Pape, "Why Economic Sanctions Do Not Work," *International Security* 22, no. 2 (1997): 90–136; Richard Haass, "Economic Sanctions: Too Much of a Bad Thing," *Brookings*, 1 June 1998, <https://www.brookings.edu/research/economicsanctions-too-much-of-a-bad-thing/>; Kimberly A. Elliott and Gary C. Hufbauer, "Same Song, Same Refrain?"

called “smart sanctions,” the discussion has shifted to examine the conditions under which sanctions are effective (e.g. the regime type, the salience of the issue, the timing of the imposition, the costs for the target, etc).¹⁸

Studies on the EU’s autonomous sanctions gained their momentum after restrictive measures became an essential tool of the Common Foreign and Security Policy, established in 1992 by the Maastricht Treaty. Following the EU’s development as a new sanctioning actor, scholars examined the effectiveness of the EU sanctions.¹⁹ In particular, Anthonius W. De Vries and Hadelwyh Hazelzet analyzed the EU’s sanctions strategy at various stages of the decision-making, including the enforcement, monitoring, and planning stages. They concluded that at all three stages, the EU is heavily reliant on its member states. To ensure the effectiveness of sanctions, member states are obliged to pass legislation on penalties. However, while some member states pass permanent legislation on the penalties, the majority of states ratify separate legislation related directly to the EU Council Decision. Due to the lengthiness of this process, the effectiveness of sanctions is affected.

Economic Sanctions in the 1990’s,” *American Economic Review* 89, no. 2 (1999): 403–408; and Gary C. Hufbauer, Jeffrey J. Schott, Kimberly A. Elliott, and Barbara Oegg, *Economic Sanctions Reconsidered*, 3rd ed. (Washington, DC: Peterson Institute for International Economics, 2007).

¹⁸ See, for example, Daniel Drezner, *The Sanctions Paradox* (Cambridge: Cambridge University Press, 1999); Risa A. Brooks, “Sanctions and Regime Type: What Works, and When?” *Security Studies* 11, no. 4 (2002): 1–50; Daniel Drezner, “Sanctions Sometimes Smart: Targeted Sanctions in Theory and Practice,” *International Studies Review* 13, no. 1 (2003): 96–108; Adrian Ang and Dursun Peksen, “When Do Economic Sanctions Work? Issue Salience, Asymmetric Perception, and Outcomes,” *Political Research Quarterly* 60, no. 1 (2007): 135–45; Navin Bapat and Clifton Morgan, “Multilateral versus Unilateral Sanctions Reconsidered: A Test Using New Data,” *International Studies Quarterly* 53, no. 4 (2009): 1075–94; and Thomas Biersteker and Peter A.G. van Bergeijk, “How and When Do Sanctions Work?: The Evidence,” in *On Target?: EU Sanctions as Security Policy Tools*, eds. Iana Dreyer and José Luengo-Cabrera (Paris: EU Institute for Security Studies, 2015).

¹⁹ See, for example, Mikhael Eriksson, “EU Sanctions: Three Cases of Targeted Sanctions,” in *International Sanctions: Between Words and Wars in the Global System*, eds. P. Wallensteen and C. Staibano (London, Frank Cass, 2005); and Clara Portela, “The EU’s Use of Targeted Sanctions. Evaluating Effectiveness,” *CEPS Working Documents*, no. 391 (March 2014): 1–44.

It creates a window of opportunity for the targets to shift their capital and payments to a country where the legislation is absent or weaker.²⁰ The more complex the sanctions regime, the more difficult it is to control the movements of capital and payments. The EU lacks sufficient resources to ensure compliance, while the member states do not have an effective monitoring system. The cooperation of the private sector, largely arising out of its fear of heavy fines, proves to be a crucial element for the effectiveness of EU sanctions regimes.²¹

Violations and breaches of international sanctions have mostly been discussed in the scholarship as part of the examination of the effectiveness of sanctions. Bringing the study of sanctions and transnational crime together, Richard Naylor and Peter Andreas analyzed the criminalizing effects of sanctions in the targeted country.²² In particular, Andreas demonstrated how sanctions paradoxically contribute to the emergence of a sanctions-busting economy, including organized crime syndicates and shadowy commercial clans, leading to the spread of smuggling networks even to the neighboring countries.²³ Analyzing third-party spoilers, Bryan R. Early distinguished between profit-seeking and politically motivated sanctions-busting behavior. He examined how third-parties contribute to the mitigation of the effectiveness of the US sanctions and what might be done to counteract this.²⁴

A lot of the sanctions-busting research is done by international organizations, NGOs, think tanks, and the media. Within the UN framework, the Stockholm Process (2003)

²⁰ Anthonius W. De Vries and Hadelwych Hazelzet, "The EU as a New Actor on the Sanctions Scene," in *International Sanctions. Between Words and Wars in the Global System*, eds. Peter Wallensteen and Carina Staibano (London: Frank Cass, 2005), 99.

²¹ *Ibid.*, 101–03.

²² Richard Naylor, *Economic Warfare: Sanctions, Embargo Busting, and Their Human Costs* (Boston, MA: Northeast University Press, 2001); Peter Andreas, "Criminalizing Consequences of Sanctions: Embargo Busting and Its Legacy," *International Studies Quarterly* 49, no. 2 (2005): 335–60.

²³ *Ibid.*, 345.

²⁴ Bryan R. Early, *Busted Sanctions. Explaining Why Economic Sanctions Fail* (Stanford, CA: Stanford University Press, 2015).

introduced good practices for sanctions implementation and monitoring to counter sanctions evasion, while in 2014 the Financial Action Task Force proposed recommendations for the implementation of targeted financial sanctions to stop proliferation finance.²⁵ Several reports about targets' tactics and techniques for circumventing sanctions were produced by the UK's Royal United Services Institute (RUSI) and the Asan Institute for Policy Studies with a particular focus on North Korea and Russia. To adapt, sanctioned individuals and entities in North Korea and Russia used complex front companies and intermediaries to muddy their transactions and activities. Targeting the weakest links in the sanctions chain, Russians and North Koreans sought countries or sectors with few resources for monitoring, poor implementation, and/or low awareness of the sanctions threat.²⁶ For example, in the maritime transportation, employing a combination of legal and technical loopholes, North Korean ships bypassed sanctions to obtain an illegal amount of oil and gas from Russia.²⁷ Highlighting the differences between US and EU sanctions, the *Economist* investigated how Russian businesses find loopholes in the complex legislation and change their corporate structures to stay afloat.²⁸

Following the general trend, the analysis of US/EU sanctions towards Russia over the Ukraine crisis to date has likewise been predominantly framed from the point of view of their effectiveness. The evaluation of sanctions' economic impact and their ability to coerce Russian policy change has often prevailed. Various authors have examined whether US/EU sanctions have worked and what impact they had on Russia's economy and, vice versa, how Russia's

²⁵ FATF Targeted Financial Sanctions Experts' Meeting, 22 June 2014.

²⁶ Tom Keatinge, Emil Dall, Aniseh Bassiri Tabrizi and Sarah Lain, "Transatlantic (Mis)alignment. Challenges to US-EU Sanctions Design and Implementation," *RUSI Occasional Paper*, July 2017, 21; and Emil Dall and Tom Keatinge, "Underwriting Proliferation. Sanctions Evasion, Proliferation Finance and the Insurance Industry," *RUSI Occasional Paper*, July 2018, 1.

²⁷ The Asan Institute for Policy Studies, "The Rise of Phantom Traders: Russian Oil Exports to North Korea," *Asan Report*, July 2018, 7.

²⁸ "Fancy Footwork: How Businesses Linked to Blacklisted Oligarchs Avoid Western Sanctions," *Economist*, 12 February 2015, <https://www.economist.com/business/2015/02/12/fancy-footwork>.

counter-sanctions affected US/EU economic performance. The studies concurred that although the economic costs incurred have been considerably larger for the EU than for the US, the EU appears to have managed the burden, in part due to EU emergency funds, trade redirection, and increased purchasing power.²⁹ Embracing the multifaceted nature of sanctions, several studies focused on their political component.³⁰ The US/EU sanctions have been the most effective in sending a clear and strong signal and in constraining Russia's aggression in Eastern Ukraine.³¹ Other studies narrowed down their focus to the EU-country and firm-level analysis or to particular sectors. The sanctions costs hit the EU members disproportionately, but pain from economic sanctions appeared to have no correlation with countries' sanctions positions. Surprisingly, countries that suffered the most proved to be the most hawkish in their attitudes towards Russia.³² Bearing the main costs,

²⁹ See, for example, Erica Moret and Maria Shagina, "The Impact of EU-Russia Tensions on the Economy of the EU," in *Damage Assessment: EU-Russia Relations in Crisis*, eds. Lukasz Kulesa, Ivan Timofeev, and Joseph Dobbs (London: European Leadership Network, 2017), 17–24; Erica Moret, Francesco Giumelli and Dawid Bastiat-Jarosz, "Sanctions on Russia: Impacts and Economic Costs on the United States," Geneva: Graduate Institute of International and Development Studies, 20 March 2017; Daniel Gros and Mattia Di Salvo, "Revisiting Sanctions on Russia and Counter-Sanctions on the EU: The Economic Impact Three Years Later," *CEPS Commentary*, 13 July 2017; Austrian Institute of Economic Research (WIFO), "Disrupted Trade Relations between the EU and Russia: The Potential Economic Consequences for the EU and Switzerland," 2015; Daniel Gros and Federica Mustilli, "The Economic Impact of Sanctions Against Russia: Much Ado About Very Little," *CEPS Commentary*, 23 October 2015; and Michael Emerson, "The EU-Ukraine-Russia Sanctions Triangle," *CEPS Commentary*, 13 October 2014.

³⁰ See, for example, Ernest Wyciszkievicz, "Crime Brings Punishment: The Importance of Sanctioning Russia," in *A Successful Failure: Russia After Crime(a)*, eds. Olga Irisova et al. (Warsaw: The Centre for Polish-Russian Dialogue and Understanding, 2017), 33–46; Erica Moret et al., "The New Deterrent? International Sanctions against Russia over the Ukraine Crisis: Impacts, Costs and Further Action," Geneva: Programme for the Study of International Governance, Graduate Institute, 12 October 2016; and Viljar Veebel and Raul Markus, "Lessons from the EU-Russia Sanctions 2014–2015," *Baltic Journal of Law & Politics* 8, no. 1 (2015): 165–94.

³¹ Moret et al., "The New Deterrent?" 11.

³² See, for example, Francesco Giumelli, "The Redistributive Impact of Restrictive Measures on EU Members: Winners and Losers from Imposing Sanctions on

the private sector was significantly hit by the sanctions and incurred collateral damage on its business activities.³³ In the energy sector, the collateral damage proved to be triggered by financial and technology-oriented sanctions.³⁴

The second strand of literature analyzes the sanctions from Russia's perspective, examining how Russia responded and adapted to them. In an attempt to shield itself from the external threats, Russia moved to "securitize" its economic policy, by enhancing its economic sovereignty and by pivoting to Asia.³⁵ Scholars are divided, however, on the question of the sanctions' outcome: while some argue that sanctions triggered consolidation around the Kremlin regime,³⁶ others show that sanctions failed to cause a "rally-around-the-flag" effect and put an enormous strain on Russia's balance of power, fostering a divide within the elites.³⁷ Meanwhile, analysis of the implementation and enforcement of US and EU sanctions in Russia has been rare. Although the importance of

Russia," *Journal of Common Market Studies* 55, no. 5 (2017): 1062–1080; and Maria Shagina, "Friend or Foe? Mapping the Positions on EU Member States on Russia Sanctions," London: European Leadership Network, 28 June 2017.

³³ See, for example, Matthieu Crozet and Julian Hinz, "Collateral Damage: The Impact of the Russia Sanctions on Sanctioning Countries' Exports," *CEPII Working Paper*, Paris: Research and Expertise on the World Economy, June 2016.

³⁴ See, for example, Tatiana Mitrova, "Shifting Political Economy of Russian Oil and Gas," Washington, DC: Center for Strategic and International Studies, March 2016; and Bud Coote, "Impact of Sanctions on Russia's Energy Sector," *Atlantic Council*, March 2018.

³⁵ See, for example, Richard Connolly and Philip Hanson, "Import Substitution and Economic Sovereignty in Russia," *Chatham House*, June 2016; and Richard Connolly, *Russia's Response to Sanctions. How Western Economic Statecraft is Reshaping Political Economy in Russia* (Cambridge: Cambridge University Press, 2018).

³⁶ See, for example, Anastasia Kazun, "Framing Sanctions in the Russian Media: The Rally Effect and Putin's Enduring Popularity," *Demokratyzatsiya: The Journal of Post-Soviet Democratization* 24, no. 3 (2016): 327–50.

³⁷ See, for example, Timothy Frye, "Economic Sanctions and Public Opinion: Experiments from Russia," *Comparative Political Studies*, November 2018; and Maria Snegovaya, "Tensions on the Top. The Impact of Sanctions on Russia's Poles of Power," Washington, DC: Center for European Policy Analysis, July 2018.

transatlantic unity is broadly acknowledged,³⁸ the examination of sanctions coordination and emerging loopholes with particular focus on Crimea is non-existent.

This article will contribute to the body of literature on this topic in the following ways. Moving beyond the question of the effectiveness of sanctions, this article brings in a criminological perspective to the study of sanctions. Looking at the cases of sanctions compliance, it will examine the patterns of sanctions-busting. Second, while most of the studies look at the targeted country and its adaptation strategy, this article will focus on the practices of sanctions circumvention by commercial actors in the country-sender. Finally, this article will introduce a legal aspect into the IR studies, by providing a legal assessment of Western firms' activities. It will juxtapose companies' justification for their behavior with the legal framework.

International Sanctions Regime vis-à-vis Crimea

The international community strongly opposed Crimea's illegal referendum in 2014 and its subsequent annexation by Russia. The annexation, together with further Russian military involvement in Eastern Ukraine, is a violation of the international norms, including the UN Charter's norm on the prohibition of use of force. While the right to self-determination is guarded by international law, scholars agree that such a right cannot automatically justify foreign military involvement or intervention.³⁹

³⁸ See, for example, Simond de Galbert, "Transatlantic Economic Statecraft. Building a Balanced Transatlantic Sanctions Policy between the United States and the European Union", Economic Statecraft Series, Center for Strategic & International Studies/Center for a New American Security, 21 June 2016; and Tom Keatinge and Emil Dall, "Consensus for Action: Towards a More Effective EU Sanctions Policy," Perspectives on Sanctions Series, New York: Center for Global Energy Policy, November 2018.

³⁹ See, for example, Peter Hilpold, "Self-Determination and Autonomy: Between Secession and Internal Self-Determination," in *Autonomy and Self-Determination: Between Legal Assertions and Utopian Aspirations*, ed. Peter Hilpold (Cheltenham: Edward Elgar, 2017), 42.

Accordingly, Russia's aggressive actions were seen as one of the most serious threats to the rule-based international order since the end of the Cold War. Following the US' strong response, EU and Canada expressed condemnation of Russia's unilateral change of borders. Other US and EU allies such as Australia, Japan, Switzerland, and Norway joined in stating their disapproval of Russia's change of the status quo by force. A series of diplomatic and restrictive measures were introduced by Western allies. However, a number of countries did not support the United Nations resolution 68/262 on the invalidity of the Crimean referendum: 58 countries abstained from the voting (e.g. Brazil, China, India, Vietnam), while 11 countries rejected the resolution altogether (e.g. Belarus, Bolivia, Nicaragua, North Korea, Syria, Venezuela). Despite the support for the UN resolution, South Korea, Singapore, and Turkey opted for a non-confrontational policy and imposed no sanctions against Russia.⁴⁰

US Sanctions

The US sanctions have the broadest application of the sanctions regimes, constituting a comprehensive ban on any transactions and activities in Crimea. The purpose of the Crimea-related sanctions is to increase the diplomatic and financial costs of Russia's aggressive actions in Ukraine and to send a powerful signal about the scale of the consequences for the Russian government. On 6 March 2014, President Barack Obama declared a national emergency related to the undermining of Ukraine's sovereignty and territorial integrity and the Russian occupation of Crimea. Executive Order 13660 authorized sanctions on individuals and entities belonging to those who were responsible for the situation in Crimea. Expanding the scope of the national emergency, three other Executive Orders 13661, 13662, and 13685 were issued, condemning Russia's "purported

⁴⁰ United Nations, "General Assembly Adopts Resolution Calling upon States Not to Recognize Changes in Status of Crimea Region," *Meeting Coverage and Press Releases*, 27 March 2014.

annexation of Crimea and its use of force in Ukraine.”⁴¹ Executive Order 13685 defined a set of specific measures with respect to Crimea. First, the US prohibited new investment by US citizens, including in the energy sector. Under Directive 4, Russia-related sanctions prohibited the provision, export, or re-export of goods, technology, and services for Russia’s deepwater, Arctic offshore, and shale oil exploration and production projects. The provision referred to Russia or any other maritime area claimed by Russia and extending from its territory, *de facto* including the Black Sea shelf area extending from Crimea.⁴²

The second measure barred the importation and exportation of any goods, technology, or services, directly or indirectly, into or from the US. Later, Export Administration Regulations were amended, with an extra-territorial effect: the export or re-export of items to Crimea was banned even for non-US citizens.⁴³

Finally, the Executive Order banned any approval, financing, facilitation, or guarantee by a US or foreign person of a transaction. Section 6 of the Executive Order 13685 stipulated that any transaction that “has the purpose of evading or avoiding, causes a violation” and thus is prohibited.⁴⁴ To minimize the negative effects for the civilian population, certain transactions were allowed under General Licenses, including agricultural products, medicine,

⁴¹ US Department of the Treasury, “Blocking Property of Additional Persons Contributing to the Situation in Ukraine,” Executive Order 13662, *Federal Register* 79, FR 13491, 20 March 2014, <https://www.federalregister.gov/documents/2014/03/10/2014-05323/blocking-property-of-certain-persons-contributing-to-the-situation-in-ukraine>.

⁴² US Department of the Treasury, “Blocking Property of Certain Persons and Prohibiting Certain Transactions With Respect to the Crimea Region of Ukraine,” Executive Order 13685, *Federal Register* 79, FR 77357, 19 December 2014, <https://www.federalregister.gov/documents/2014/12/24/2014-30323/blocking-property-of-certain-persons-and-prohibiting-certain-transactions-with-respect-to-the-crimea>.

⁴³ Bureau of Industry and Security, Commerce, “Russia Sanctions: Licensing Policy to the Crimea Region of Ukraine,” *Federal Register* 80, FR 4776, 29 January 2015, <https://www.federalregister.gov/documents/2015/01/29/2015-01638/russian-sanctions-licensing-policy-for-the-crimea-region-of-ukraine>.

⁴⁴ US Department of the Treasury, “Blocking Property of Certain Persons and Prohibiting Certain Transactions with Respect to the Crimea Region of Ukraine,” Executive Order 13685, 19 December 2014.

medical supplies, personal remittances, and software.⁴⁵ In August 2017, the Countering America's Adversaries Through Sanctions Act (CAATSA) introduced sanctions with respect to certain transactions with foreign sanctions evaders, namely, with any person who "materially violates, attempts to violate, conspires to violate, or causes a violation" or "facilitates a significant transaction".⁴⁶ Criminal penalties for breaching US sanctions include fines of up to \$1 million and twenty years' imprisonment. Administrative penalties for each violation are \$250,000. Breaching US sanctions may also lead to the offender being included on the sanctions list.⁴⁷

EU Sanctions

In accord with the US, in March 2014 the EU strongly condemned "the unprovoked violation of Ukrainian sovereignty and territorial integrity" and called on Russia to immediately withdraw.⁴⁸ The EU leaders agreed to suspend the negotiations on visa liberalization and Russia's participation in the G8. Later, the European Council introduced additional restrictive measures, including travel bans and asset freezes vis-à-vis 33 Russian and Ukrainian officials who

⁴⁵ US Department of the Treasury, "Authorizing the Exportation or Reexportation of Agricultural Commodities, Medicine, Medical Supplies, and Replacement Parts," General License Number 4, *US Department of the Treasury official website*, 19 December 2014, https://www.treasury.gov/resource-center/sanctions/programs/documents/ukraine_gl4.pdf; and US Department of the Treasury, "Authorizing Certain Activities Prohibited by Executive Order 13685 of December 19, 2014 Necessary to Wind Down Operations Involving the Crimea Region of Ukraine," General License Number 5, *US Department of the Treasury official website*, 30 December 2014, https://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_gl5.pdf.

⁴⁶ US Department of the Treasury, "Countering America's Adversaries Through Sanctions Act," Section 228, Public Law 115-44, *US Department of the Treasury official website*, 2 August 2017, <https://www.treasury.gov/resource-center/sanctions/Programs/Pages/caatsa.aspx>.

⁴⁷ Lloyd's List, "Out of Sight, Out of Mind," 17.

⁴⁸ European Council, "Statement of the Heads of State and Government on Ukraine," *European Council official website*, 6 March 2014, <https://www.consilium.europa.eu/media/29285/141372.pdf>.

supported the annexation of Crimea.⁴⁹ From 23 June 2014, as part of the EU's non-recognition policy, a certificate from the Ukrainian authorities was required in order to import goods originating from Crimea and Sevastopol.⁵⁰ After the downing of the Malaysian Airlines flight MH17 in July 2014, further trade and investment restrictions in certain sectors such as transport, telecommunications, and energy, including the exploration and production of oil, gas, and minerals, were imposed.⁵¹ In response to the lack of progress in implementing the Minsk Protocol, in December 2014 the EU substantially expanded its Crimea-related sanctions. European or EU-based companies were prohibited from acquiring or investing in real estate or entities in Crimea and Sevastopol and from supplying related services. The provision of financial and technical assistance, brokering, construction, and engineering services related to the infrastructure projects in Crimea were banned, as was the supply of key equipment and technology for the exploration of natural resources. European Union operators were prohibited from offering tourism services, while the ship cruising services were not allowed to call at any port on the Crimean Peninsula other than in the event of an emergency. This measure applied to all vessels owned by EU nationals or registered under EU

⁴⁹ Council of the European Union, "EU Adopts Restrictive Measures against Actions Threatening Ukraine's Territorial Integrity," *Official Journal of the European Union*, 17 March 2014, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0269&from=GA>; Council of the European Union, "Implementing Decision 2014/145/CFSP concerning Restrictive Measures in respect of Actions Undermining or Threatening the Territorial Integrity, Sovereignty and Independence of Ukraine," *Official Journal of the European Union*, 21 March 2014, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0145&from=CS>.

⁵⁰ Council of the European Union, Council Decision 2014/386/CFSP of 23 June 2014 concerning restrictions on goods originating in Crimea or Sevastopol, in response to the illegal annexation of Crimea and Sevastopol, *Official Journal of the European Union*, 23 June 2014, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014D0386>.

⁵¹ Council of the European Union, Council Decision 2014/507/CFSP of 30 July 2014 amending Decision 2014/386/CFSP concerning restrictions on goods originating in Crimea or Sevastopol, in response to the illegal annexation of Crimea and Sevastopol, *Official Journal of the European Union*, 30 July 2014, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0507&rid=1>.

jurisdiction. Contracts signed prior to 20 March 2015 were exempted from the regulation.⁵²

In November 2016, the EU introduced restrictive measures against six Crimean individuals who became members of the Russian State Duma as a result of the elections in Crimea in September 2016.⁵³ In August 2017, 3 Russian nationals and 3 companies were added to the list due to their involvement in the transfer of the Siemens gas turbines to Crimea. In June 2018, the EU added another six Russian entities to the sanctions list over their involvement in the construction of Kerch Bridge. The EU claimed that through their actions the companies had “supported the consolidation of Russia’s control” over Crimea which in turn contradicted EU’s non-recognition policy.⁵⁴

While the Crimea-related sanctions imposed by other allies are open-ended, the EU extends its restrictive measures each year. At the time of writing, [August/2018], the sanctions are in place until 31 July 2019. As the implementation and enforcement is the responsibility of the national governments of the member states, penalties for the violation of sanctions vary. For example, the UK’s newly established Office of Financial Sanctions Implementation issues a monetary penalty up to 1 million pounds or 50% of the estimated value of funds involved in a transaction. Criminal penalties include a prison sentence of up to seven years. In Germany,

52 Council of the European Union, Council Decision 2014/933/CFSP of 18 December 2014 amending Decision 2014/386/CFSP concerning restrictive measures in response to the illegal annexation of Crimea and Sevastopol, *Official Journal of the European Union*, 18 December 2014, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0933&from=NL>.

53 Council of the European Union, “Russia: EU adds 6 members of the State Duma from Crimea to sanctions list over actions against Ukraine’s territorial integrity,” *Council of the European Union official website*, 09 November 2016, <https://www.consilium.europa.eu/en/press/press-releases/2016/11/09/sanctions-list-over-actions-against-ukraines-territorial-integrity/>.

54 Council of the European Union, “Ukraine: EU Adds Six Entities involved in the Construction of the Kerch Bridge connecting the Illegally Annexed Crimea to Russia to Sanctions List,” *Council of the European Union official website*, 31 July 2018, <https://www.consilium.europa.eu/en/press/press-releases/2018/07/31/ukraine-eu-adds-six-entities-involved-in-the-construction-of-the-kerch-bridge-connecting-the-illegally-annexed-crimea-to-russia-to-sanctions-list/>.

under the Foreign Trade and Payments Act violation of the UN or EU sanctions carries a prison sentence from one to ten years.⁵⁵

Weaknesses within and across Sanctions Regimes

The international sanctions regimes put in place in response to Russia's wrongdoings in Ukraine contain various kinds of weaknesses and loopholes. While one kind of weaknesses stems from sanctions design and internal decision-making, others are a result of a lack of coordination between allies.

In comparison with the US, the EU sanctions regime is weaker and less flexible. In order to initiate, maintain, or adapt sanctions, the EU has to obtain the unanimous consent of all 28 member states. The EU's requirement of unanimity shapes the design of sanctions to a great degree. It is the EU member states who decide whether sanctions are imposed, what type, and to what extent.⁵⁶ Due to diverging national security issues and economic interests within the EU, its sanctions list includes more individuals than businesses, including those on the sectoral list.⁵⁷ As the EU's economic dependency on Russia is higher than that of the US, the EU does not target the gas sector or key persons associated with the Putin regime. In addition, the EU sanctions include a so-called grandfather clause which validates pre-existing contracts, allowing European companies to do business with sanctioned entities.⁵⁸

Second, the peculiarities of the EU's decision-making make its sanctions regime less flexible. As each member state has the right to veto sanctions, this considerably limits the EU's ability to act.⁵⁹ Although member states should act "in a spirit of loyalty and mutual solidarity," the EU is not eager to additionally test its fragile

⁵⁵ Federal Ministry of Economic Affairs and Energy, "Foreign Trade and Payments Act," *Federal Law Gazette*, 6 June 2013.

⁵⁶ De Vries and Hazelzet, "The EU as a New Actor on the Sanctions Scene," 98.

⁵⁷ Daniel P. Ahn and Rodney D. Ludema, "Measuring Smartness: Understanding the Economic Impact of targeted Sanctions," US Department of State, *Working Paper* 2017-01, 28–29.

⁵⁸ Jack Farchy, "EU's Russia Sanctions Fail to Dent Oil Deals," *Financial Times*, 14 July 2015, <https://www.ft.com/content/21d66e58-10ef-11e5-8413-00144feabdco>.

⁵⁹ Keatinge, Dall, Tabrizi and Lain, "Transatlantic (Mis)alignment," 8.

unanimity.⁶⁰ The perilous process of reaching a unanimous decision is also time-consuming. The EU's inability to react swiftly delays implementation and gives targets ample time to adjust and to find alternative solutions. The EU's slow decision-making is also more likely to be affected by companies' lobbying which can hamper the sanctions' effectiveness.⁶¹

In contrast to the EU, the US approach has proved to be more hawkish and agile. In response to Russia's evasive practices, the Office of Foreign Assets Control (OFAC) updated the legislation and closed off loopholes on several occasions. For example, in July 2015 OFAC designated additional individuals and entities as a reaction to assets being shifted from sanctioned targets to their family members and friends.⁶² In August 2017, the CAATSA officially extended restrictive measures to blacklisted persons' relatives, including spouses, children, siblings, and parents.⁶³

Another weakness derives from the EU's enforcement mechanism. Although the EU's Ukraine/Russia sanctions were designed and agreed upon unanimously at the European level, they are implemented and enforced at the level of individual member states. Due to the different capabilities of the member states, including intelligence capacities and enforcement mechanisms, and their different degrees of willingness, the implementation varies in practice.⁶⁴ For example, overseas branches of some sanctioned Russian banks were exempted from sanctions in Austria, Germany, Cyprus, and France, as it was feared that the sanctions could lead to a negative systemic effect on the EU's banking sector.⁶⁵

⁶⁰ European Union, Treaty of Nice, Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, *Official Journal of the European Communities*, 10 March 2001.

⁶¹ De Vries and Hazelzet, "The EU as a New Actor on the Sanctions Scene," 99.

⁶² US Department of the Treasury, "Treasury Sanctions Individuals and Entities Involved in Sanctions Evasion Related to Russia and Ukraine," *US Department of the Treasury official website*, 30 July 2015. <https://www.treasury.gov/press-center/press-releases/Pages/jlo133.aspx>.

⁶³ US Department of the Treasury, "Countering America's Adversaries Through Sanctions Act," Public Law 115-44, 2 August 2017.

⁶⁴ Iana Dreyer and José Luengo-Cabrera, "Introduction," in *On Target?*, eds. Dreyer and Luengo-Cabrera, 10.

⁶⁵ Keatinge, Dall, Tabrizi and Lain, "Transatlantic (Mis)alignment," 8.

The legal contradictions within the sanctions regimes itself create another opportunity for the private sector to bypass sanctions. For example, the Kerch Commercial Sea Port became a convenient excuse for companies to exploit the legal inconsistencies. No transactions or activities are allowed with this port, which is a sanctioned entity on both the US and EU sanctions lists. However, in order to ship goods to Ukrainian ports in the Sea of Azov, transit dues and an obligatory pilotage fee must be paid to this port. As an unintended consequence, trading vessels destined for the Sea of Azov face a double risk—they can be fined either for breaching Western sanctions, or for violating the Ukrainian maritime law. Unintended by design, this provision remains unresolved.⁶⁶

The loopholes that have emerged due to the lack of coordination between the senders also facilitate the circumvention of sanctions. In contrast to the US, EU, Canada, Australia, Switzerland, and Norway, Japan opted for only symbolic measures vis-à-vis Russia. Despite Japan's strong condemnation of Russia's change of the status quo by force,⁶⁷ Tokyo imposed light sanctions on Crimea. Although the Japanese government introduced an approval system for the import of goods from Crimea and Sevastopol, the export of goods, technology, and services was not targeted.⁶⁸ The exemption of exports became a loophole for the Crimean authorities. In 2014–2017, Toyota Camry and Toyota Land Cruisers were bought by the Crimean government, including the Prosecutor's Office.⁶⁹ Although the deal strictly speaking did not

⁶⁶ Lloyd's List, "Out of Sight, Out of Mind," 16.

⁶⁷ Ministry of Foreign Affairs of Japan, "Statement by the Minister of Foreign Affairs of Japan on the Measures against Russia over the Crimea Referendum," *Ministry of Foreign Affairs of Japan official website*, 18 March 2014, https://www.mofa.go.jp/press/release/press4e_000239.html.

⁶⁸ Ministry of Foreign Affairs of Japan, "Measures to Freeze Assets of Those Who Are Considered to Be Directly Involved in "Annexation" of the Autonomous Republic of Crimea and the City of Sevastopol or Destabilization of Eastern Part of Ukraine," *Ministry of Foreign Affairs of Japan official website*, 5 August 2014, https://www.mofa.go.jp/press/release/press4e_000387.html.

⁶⁹ "Toyota Bypassing Sanctions to Sell Cars in Crimea," *Hromadske International*, 20 July 2017, <https://en.hromadske.ua/posts/toyota-bypassing-sanctions-to-sell-cars-in-crimea>.

violate Japan's sanctions, it certainly breached the spirit of the Western sanctions.

Typology of Sanctions Circumvention

Sanctions circumvention refers to legal or illegal ways of avoiding compliance with rules or restrictions. In contrast, compliance means that "one consents to act in conformity or in accordance with some specific desire, request, condition, or direction."⁷⁰ In international law, compliance means that an actor is willing to accept international rules, regulations, and principles as binding constraints in its interactions with other actors.⁷¹ Based on the motivational postures, voluntary and enforced compliance can be distinguished. In the case of voluntary compliance, actors approve punitive measures and indicate a desire to voluntarily commit to sanctions which are seen as a moral law and as fair punishment for the target. Enforced compliance occurs when actors disagree with measures but give in due to the risk of penalties.⁷² Sanctions circumvention can thus be prompted by disagreement with the measures and/or by the authorities' inability to enforce and monitor compliance. Based on the theory of tax evasion, this article distinguishes between two types of sanctions circumvention behavior:

- *sanctions avoidance* as a legal activity within the legal framework, whereby the actor probes for loopholes within the sanctions regime with a view to reducing exposure to sanctions compliance.⁷³ In the case of sanctions avoidance, no rules are broken and no fraudulent transactions are undertaken. Sanctions

⁷⁰ Christopher C. Joyner, "Sanctions, Compliance and International Law: Reflections on the United Nations' Experience against Iraq," *Virginia Journal of International Law* 32, no. 1 (1991): 1.

⁷¹ *Ibid.*, 1.

⁷² Erich Kirchler and Ingrid Wahl, "Tax Compliance Inventory: TAX-I Voluntary Compliance, Enforced Compliance, Tax Avoidance, and Tax Evasion," *Journal of Economic Psychology* 31, no. 3 (2010): 5.

⁷³ Doreen McBarnet, "Legitimate Rackets: Tax Evasion, Tax Avoidance, and the Boundaries of Legality," *The Journal of Human Justice* 3, no. 2 (Spring 1992): 60.

avoidance escapes administrative or criminal punishment and any risk of stigma.⁷⁴ From a *moral* standpoint, however, sanctions avoidance creates a schism between the letter and the spirit of the law. As it violates the intent of the law and ethical obligations, it represents a breach of the spirit;⁷⁵

- *sanctions evasion* as an illegal activity that represents a violation of the law. The underlying motivation here is “deceit, misrepresentation and concealment.”⁷⁶ The actor’s motivation is to hide his/her activities from the authorities and to refrain from compliance with the sanctions regime. An actor that engages in evasive practices is liable to administrative and criminal penalties and carries a risk of criminal stigma.⁷⁷

The two types of behavior reflect the interaction between actors’ approval of sanctions and authorities’ capacity to monitor. Sanctions avoidance occurs when actors have incentives to search for legal loopholes within the brackets of the law but are deterred from illegal actions due to effective monitoring and enforcement. Evasion occurs when the law is ignored or broken and the authorities lack power to monitor and enforce.⁷⁸

In practice, however, the difference between avoidance and evasion is not as sharp as in the legal textbooks and the boundaries between the two may fall into the gray area. The term *avoision* has been coined to refer to cases which do not have clear or distinct boundaries and which generally shade from one to the other.⁷⁹

⁷⁴ McBarnet, “Legitimate Rackets,” 61.

⁷⁵ Graham Mansfield, “Five Ways Out of Tax: An Analysis of Avoidance Devices,” *Journal of Financial Regulation and Compliance* 2, no. 2 (January 1994): 133.

⁷⁶ McBarnet, “Legitimate Rackets,” 61.

⁷⁷ Agnar Sandmo, “The Theory of Tax Evasion: A Retrospective View,” *National Tax Journal* LVIII, no. 4 (December 2005): 645.

⁷⁸ Kirchler and Wahl, “Tax Compliance Inventory,” 3–5.

⁷⁹ Arthur Seldon, “Prologue to Avoision: The Moral Blurring of a Legal Distinction Without an Economic Difference,” in *Tax Avoision: The Economic, Legal and Moral Inter-relationship between Avoidance and Evasion*, ed. Alfred Roman Ileric (London: Institute of Economic Affairs, London, 1979), 51–70.

Actors practicing avoision use law and legal definitions as “a vehicle for exploitation” to serve their own interests and to disguise evasion as avoidance.⁸⁰ “Getting it wrong is not of itself an indication of evasion if you can provide evidence that you tried to get it right.”⁸¹ Indeed, through the provision of evidence actors try to ensure their compliance in form but not in substance.⁸²

Following this typology, the next part will evaluate Western companies’ practices in circumventing sanctions. Drawing on practical cases, the article will illustrate the techniques employed by the private sector to circumvent sanctions and will explore the boundaries between law-breaking and law-abiding activities.

Sanctions Circumvention: Practices and Cases

Over the last four years, the media has often reported on cases of sanctions breaches by Western firms. In many cases, the verdict—that the sanctions regime had been violated—was reached based on the spirit of the law rather than the letter. The purpose of this part is to provide a legal assessment of the cases where Western firms were involved. Juxtaposing companies’ business activities in Crimea to the legal framework of sanctions, the article labels the individual cases as instances of sanctions evasion, sanctions avoidance, or the gray area, avoision, where the boundaries are less clear. The cases discussed below are arranged in order of importance.

Sanctions Avoision Case I: Shipping Companies

Context: despite Western restrictions on shipping activities in Crimea, a number of vessels docked in Crimea in violation of the sanctions. In 2014 the number of vessels dropped to 2,002, but in 2015 it expanded by 50%, equating to roughly the same number of ship calls as in 2013—prior to the sanctions. In particular, the number of ships with links to the EU grew by 23.4% for the year of

⁸⁰ Mansfield, “Five Ways Out of Tax,” 133.

⁸¹ McBarnet, “Legitimate Rackets,” 66.

⁸² *Ibid.*, 67.

2015, with German-, Italian-, and Greek-registered vessels featuring most frequently. Similarly, the number of US-linked vessels increased from 18 in 2014 to 21 in 2015.⁸³

Technique: foreign ships use a combination of manipulative techniques to avoid sanctions. First, the ship owners use “flags of convenience,” a common practice in the maritime industry whereby vessels are re-registered with a country different to that of the ship owner. The vessels are usually registered under fictitious names and change operating companies frequently. The most common flags of convenience that enter Crimea are Russian, Togolese, and Panamanian. As ships are bound to adhere to the rules of their country of registration, it is convenient for the ship owner to register with a country which did not impose sanctions. Next, to hide the trail, various deceptive techniques are employed, ranging from switching off the radar from the Automatic Identification System (AIS) navigation system, loitering, routing to non-sanctioned ports, and transshipment in open waters.⁸⁴

As a *Black Sea News* investigation revealed, in November–December 2017 two German shipping companies and a Norwegian mining company became involved in an illegal scheme involving the supply of ilmenite (titanium) ore to the Kerch port of Kamysh-Burun. On 3–6 November 2017, the German bulk ship HHL MISSISSIPPI, which belongs to German Hansa Heavy Lift GmbH, received ten thousand tonnes of ilmenite in the Norwegian port of Jøssingfjorden, one of the largest titanium mines in Western Europe which belongs to Norway’s Titania Kronos. After a brief stop in the Dutch port of Ijmuiden where it uploaded construction materials, HHL MISSISSIPPI set course for the Romanian port of Constanza. After offloading the materials, on 22 November the German cargo ship entered the Russian port of Kavkaz under the Liberian flag and stayed until 5 December. Because of a low bridge, the German ship could not enter the port and had to dock at the Kavkaz roadstead.

⁸³ Lloyd’s List, “Out of Sight, Out of Mind,” 13.

⁸⁴ Oleksandr Humeniuk, Maksym Kytsiuk, Olena Loginova and Andrii Ianitskyi, “International Trade with Crimea Ongoing despite Sanctions,” *Organized Crime and Corruption Reporting Project*, 15 August 2015, <https://www.occrp.org/en/investigations/5553-international-trade-with-crimea-ongoing-despite-sanctions>.

During this stay, a Russian cargo ship NEFTERUDUVOZ-2 approached HHL MISSISSIPPI at least three times to receive the transshipment of ilmenite on the open sea. The Russian vessel then allegedly delivered the HHL MISSISSIPPI's cargo to the Kerch port of Kamysh-Burun. The same scheme was later used by the German cargo ship Callisto owned by German Heinz Corleis Reederei KG. It is believed that both deliveries were meant for the sole buyer of ilmenite in Crimea, the plant Titan which belongs to the Ukrainian oligarch Dmytro Firtash.⁸⁵

Justification: Both German companies use the same justification for their activities and claim to have no knowledge about the final destination. Heinz Corleis KG does not accept responsibility for the violation: "We confirm that in 2017 Callisto fulfilled a transportation order from Norway to Kavkaz. As for where the cargo was transported after the end of the contract, we have no knowledge and it's outside of our responsibility."⁸⁶ Similarly, Hans-Joerg Simon from Hamburger Hansa Heavy Lift does not acknowledge any violation of the sanctions regime, and points out that the company performed an embargo check in line with the German export control instructions before the delivery. "This ilmenite is not subjected to any restrictions vis-à-vis Russia at least. We did not go to Crimea and we did not know that the end user is in Crimea."⁸⁷ He argues that the company could not know about the final destination based on the sole fact that the ship was supposed to return after a couple of hours. Jan Larsen, a Titania Kronos director, asserted that the company had "no direct sales" to Crimea and that it was currently clarifying the issue with the Ministry of

⁸⁵ "German Ship Delivers 10,000 Tons of Ilmenite from Norway to the Occupied Crimea's Titan Plant—A BSNews Investigation," *Black Sea News*, 27 December 2017, <https://www.blackseanews.net/en/read/137635>.

⁸⁶ Sabine Adler, "Deutsche Firmen des EU-Sanktionsbruchs verdächtigt," *Deutschlandfunk*, 6 July 2018, https://www.deutschlandfunk.de/verbotene-lieferungen-auf-die-krim-deutsche-firmen-des-eu.724.de.html?dram:article_id=422056.

⁸⁷ *Ibid.*

Foreign Affairs. He declined to comment on the identity of the end buyer of ilmenite or on why the ships sailed to the Kerch Strait.⁸⁸

Legal assessment: According to the EU Council Regulation 825/2014, the export supply of titanium ore to Crimea and Sevastopol is strictly forbidden, including to Kamysh-Burun, an EU-sanctioned port.⁸⁹ Moreover, in June 2014 the Ukrainian authorities closed all the Crimean ports, so any ship docking in Crimea would be in violation of the Ukrainian law. Norway fully aligned with EU's Crimea sanctions and banned the sale, delivery, transport, or export of goods, including minerals.⁹⁰ Under the current legislation, both European and Norwegian companies are obliged to conduct due diligence to establish the end buyer and the final destination of the goods. It is companies' direct responsibility to make sure that the goods do not end up in Crimea.⁹¹ In addition, the EU does not condone the participation of EU companies in activities whose purpose is to circumvent sanctions, regardless of the location—either in Crimea or anywhere else, including Russia. The EU's position on this rule is unambiguous: EU companies must not “participate, knowingly or intentionally, in activities the object or effect of which is to circumvent the prohibitions.”⁹² However, EU regulation includes a provision which reads that if the party “did not know, and had no reasonable cause to suspect that their actions would infringe the measures set out in the Regulation,” then the party would be able to rely on this defense.⁹³ For example, this provision may work if the cargo was loaded in an intermediate port

⁸⁸ Nina Berglund, “UD Probes Possible Sanctions Violation,” *News in English.no*, 31 January 2018, <http://www.newsinenglish.no/2018/01/31/ud-probes-possible-sanctions-violation/>.

⁸⁹ Council Regulation No 825/2014, 30 July 2014.

⁹⁰ Ministry of Foreign Affairs of Norway, “Norway to Implement New Restrictive Measures against Russia,” *Government.no*, 11 August 2014, <https://www.regjerinngen.no/en/aktuelt/Norway-to-implement-new-restrictive-measures-against-Russia/id765675/>.

⁹¹ Council Decision 933, 18 December 2014.

⁹² *Ibid.*

⁹³ “Maritime Legal Issues arising out of Trading to Ukraine/Crimea. New EU Sanctions and Ukraine Directive,” *Ince & Co*, 21 July 2014, <https://www.incelaw.com/en/knowledge-bank/maritime-legal-issues-arising-out-of-trading-to-ukraine-crimea>.

and the party had no control over it. This get-out clause is significant, as it underlines the importance of due diligence, but also indicates a potential loophole. As long as the company can prove that enough screening was done and that it did not know that it was violating the sanctions, the case would be likely to be judged as a matter of sanctions avoidance, but not sanctions evasion.

Nevertheless, evaluating German companies' activities and justifications, it is hard to agree that sufficient due diligence was performed. The claim that the delivery was destined to Russia has no real support. According to Andrii Klymenko, a *Black Sea News* activist, Russia does not need to import ilmenite, as the country produces its own supply in the Urals. The only buyer of ilmenite in the vicinity is the Crimean plant Titan.⁹⁴ Moreover, both companies showed a lack of vigilance and a failure to consult adequately with the German government authorities for export control. Given the proximity of the Russian port of Kavkaz to the Crimean coast (a distance of only 20 km), it would be reasonable to expect from the companies to conduct a thorough due diligence.

Currently, the activities of both the German and Norwegian companies are under investigation. This illegal scheme of export supply clearly borders on sanctions evasion. The final decision on whether the companies in question breached sanctions will be judged by the degree of their due diligence.

Sanctions Avoidance Case II: Bridge Constructors

Context: in May 2018, Russia completed the construction of the Kerch bridge connecting Crimea and the Russian mainland. In 2017, there were reports that two Dutch companies, Dematec Equipment and Bijlard Hydrauliek, were providing machines, machine parts, and other services for the construction of this bridge.⁹⁵ In the wake of the media allegation, Lilianne Ploumen, the Dutch Minister for Foreign Trade and Development Cooperation, reiterated the

⁹⁴ Adler, "Deutsche Firmen des EU-Sanktionsbruchs verdächtigt."

⁹⁵ "Obkhodnye puti," *Kommersant*, 14 September 2017, <https://www.kommersant.ru/doc/3410460>.

government's non-recognition policy of Crimea and that it "does not in any way stimulate activities that contribute to the normalization of the situation."⁹⁶ Eventually, the Dutch Public Prosecutor launched an investigation against seven Dutch companies believed to be involved in the bridge's construction.⁹⁷ In June 2017, the EU added six Russian companies involved in the construction of the Kerch Bridge.⁹⁸

Technique: the two Dutch companies used different techniques to enable the delivery of the prohibited goods. Dematec Equipment, which was responsible for a hydraulic impact hammer, shipped the equipment to Russia in early 2016. The equipment was assembled on Russian territory. In the case of Bijlard Hydrauliek, an intermediary company was used. The Dutch company built an important part of the hammer and delivered it to a customer in the Netherlands.

Justifications: the two companies deny that their activities constitute a violation of the sanctions regime. Derk van den Heuvel, director of Dematec Equipment opined that "the sanctions had not been breached because the equipment was assembled on Russian territory."⁹⁹ He emphasized that "EU sanctions state that we are not allowed to work in Crimea, but we can in Russia."¹⁰⁰ The second company Biljard Hydrauliek "was unaware that its parts would be used to build the bridge."¹⁰¹ In particular, Marcel Biljard claimed that "We simply supplied to a customer in the Netherlands. That's all."¹⁰²

⁹⁶ "Scandal as Dutch Companies Help Build Bridge to Occupied Crimea, Violating Sanctions," *Euromaidan Press*, 6 September 2017, <http://euromaidanpress.com/2017/09/06/dutch-government-to-investigate-companies-helping-russia-build-bridge-to-occupied-crimea/>.

⁹⁷ "Krim-Brücke: Ermittlungen gegen niederländische Firmen," *ORF.at*, 4 May 2018, <https://orf.at/stories/2436740/>.

⁹⁸ Council of the European Union, "Ukraine: EU Adds Six Entities involved in the Construction of the Kerch Bridge Connecting the Illegally Annexed Crimea to Russia to Sanctions List," *Press Release*, 31 July 2018.

⁹⁹ "Dutch Companies Investigated for Supplying Equipment for Russian Bridge," *Dutchnews.nl*, 4 September 2017, <https://www.dutchnews.nl/news/2017/09/dutch-companies-investigated-for-supplying-equipment-for-crimean-bridge/>.

¹⁰⁰ *Ibid.*

¹⁰¹ *Ibid.*

¹⁰² *Ibid.*

Legal assessment: Council Regulation 825/2014 prohibits the sales and provision of key equipment and technology in the infrastructure sector to persons in Crimea or for use in Crimea. Dematec Equipment's justification that EU sanctions allow them to work in Russia refers to only part of the provision. The same article in the Council Regulation continues to argue it is "prohibited to participate, knowingly or intentionally, in activities the object or effect of which is to circumvent the prohibitions."¹⁰³ Since it was assisting in the construction of the bridge, the company could hardly claim that it did not know about the nature of the project.

In the case of Bijlard Hydrauliek, the legal assessment should be made based on the degree of due diligence. By claiming that it was not aware of the final destination for its goods, the company is attempting to use the get-out clause. If the company can prove that an intermediary company, which the equipment was sold to, had no prior public record of exporting goods to Russia, this justification may be sufficient and the case can be classified as avoidance. However, if the intermediary company was used as a cover-up and Bijlard Hydrauliek knew about the final destination, this would be an illegal activity aimed at sanctions evasion. The main problem here is defining what level of due diligence is sufficient to prove the company's justification. The legal boundaries between evasion and avoidance will likely be context-specific.

Another exploitation of the legal boundaries of the sanctions regimes is the location of the bridge. Being located outside the Crimean peninsula in the sea, the bridge does not strictly fall under the Crimea sanctions. However, the purpose of the bridge contradicts the EU sanctions at its core. By physically connecting Crimea with the mainland Russia, the bridge consolidated Russia's control over the peninsula and further undermined Ukraine's territorial integrity. As Ploumen rightly stressed, "even if laws were

¹⁰³ Council of the European Union, "Council Regulation No 825/2014 amending Regulation (EU) No 692/2014 concerning restrictions on the import into the Union of goods originating in Crimea or Sevastopol, in response to the illegal annexation of Crimea and Sevastopol," *Official Journal of the European Union*, 30 July 2014, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L.2014.226.01.0002.01.ENG>.

not formally broken, the Dutch government expects companies to conduct socially responsible behaviour.”¹⁰⁴

Sanctions Avoision Case III: Credit Card Companies

Context: in April 2014, the US expanded its sanctions, blacklisting Russian individuals and entities from Putin’s financial circle. This included Bank Rossiya and Sobinbank, linked to Yuri Kovalchuk, as well as SMP Bank and InvestCapitalBank, associated with Arkadii and Boris Rotenberg.¹⁰⁵ Both Visa and MasterCard, the world’s largest US-based credit and debit card companies, suspended their services in Crimea and blocked the blacklisted Russian banks from using their payment system. “Due to the latest U.S. sanctions imposed against Crimea by Executive Order 13685 of December 19, 2014, Visa is now prohibited from offering Visa-branded products and services to Crimea. This means that we can no longer support card issuing and merchant/ATM acquiring services in Crimea,” the Visa statement read.¹⁰⁶ MasterCard followed and also withdrew from the region due to the sanctions.¹⁰⁷ However, in early 2016 the media reported that Visa and MasterCard were back on the Crimean market.¹⁰⁸ Crimean Visa and MasterCard holders were able to make transactions and withdrawals from their accounts again as long as they were inside Russia.

Technique: in May 2014, the Russian government passed a new law “On the National Payment Card System.” The purpose of the new law was to mitigate the harm inflicted on Russia’s banking

¹⁰⁴ “Scandal as Dutch Companies Help Build Bridge.”

¹⁰⁵ Peter Baker, “U.S. Expands Sanctions, Adding Holdings of Russians in Putin’s Financial Circle,” *The New York Times*, 28 April 2014, <https://www.nytimes.com/2014/04/29/world/asia/obama-sanctions-russia.html>.

¹⁰⁶ Andrey Ostroukh, “Visa Suspends Operations in Crimea,” *The Wall Street Journal*, 26 December 2014, <https://www.wsj.com/articles/visa-suspends-operations-in-crimea-1419609876>.

¹⁰⁷ “MasterCard vsled za Visa prekratila obsluzhivat Krym,” *BBC*, 26 December 2014, https://www.bbc.com/russian/rolling_news/2014/12/141226_rn_mastercard_crimea.

¹⁰⁸ “Visa, MasterCard Cards to Resume Functioning in Crimea in April,” *Russia Beyond*, 6 February 2015, https://www.rbth.com/news/2015/02/06/visa_mastercard_cards_to_resume_functioning_in_crimea_in_april_43497.html.

sector by Western sanctions. According to the new legislation, credit institutions wishing to keep their business in Russia should move their transactions to the new system. The law required the credit card companies to pay interim contributions quarterly to the Central Bank of Russia, which amounted to 25% of their average daily turnover.¹⁰⁹ If Visa and MasterCard did not fulfill the requirements, they would have paid a huge security deposit.¹¹⁰

By the end of 2014, Visa and MasterCard agreed to gradually move the processing of the US companies' transactions within Russia under the roof of Russia's national payment system. They were obliged to transfer their traffic by 31 March 2015. As sole owner of the payment system, the Central Bank of Russia acted as a settlement office. All international transactions were to be cleared through the Russian banking center before the data were transmitted to the US. For that purpose, the National Payment Card System "cracked" the files of Visa and MasterCard.¹¹¹ Transactions would usually omit any references to Crimea but indicate "Russia" as the place of operation. "All transactions will be processed by our center. America won't even see and will not be able to block anything. Russian bank cards, Ukrainian, German, American, Japanese—any [cards], there will be no problem with that," explained Anatolii Aksakov, deputy head of the State Duma's financial committee.¹¹²

As the Ukrainian banks have left the peninsula and the major Russian banks feared international sanctions, less known Russian banks, usually with shady corporate structures, replaced Sberbank, VTB, and others. The Russian National Commercial Bank (RNKB) and Genbank became the main banking institutions to quickly expand their branches. Later, both Genbank and RNKB were added

¹⁰⁹ "National Russian Card Payment System Established," *RT*, 5 May 2014, <https://www.rt.com/business/156912-russian-putin-card-payment/>.

¹¹⁰ Andrei Ostroukh, "Russia Launches Local Electronic Payment System," *The Wall Street Journal*, 15 December 2015, <https://www.wsj.com/articles/russia-launches-local-electronic-payment-system-1450195940>.

¹¹¹ "Novaia kartochka Kryma. Poluostrov podkliuchilsia k Visa," *Kommersant*, 21 January 2016, <https://www.kommersant.ru/doc/2901471>.

¹¹² "Visa, MasterCard Cards to Resume Functioning in Crimea in April," *Russia Beyond*, 6 February 2015.

to the OFAC blacklist and Visa and MasterCard blocked their operations. Until August 2018, Genbank was the only bank issuing new credit cards. However, in August 2018, the bank announced its decision to stop issuing new cards and to switch to the Russian-based payment card “Mir.”¹¹³

Justification: from the standpoint of Visa and MasterCard, the companies were outwitted by the Russian government and were *de facto* forced to partake in sanctions circumvention. According to a source familiar with the situation, when the National Payment Card System was created, the companies were compelled to transfer all their Russian operations, including the Crimean ones, for the processing. Their withdrawal from the Russian market would mean a substantial loss in the market share. The companies claim that *de jure* they adhere to the sanctions, but *de facto* they have no control over transactions.¹¹⁴

Legal assessment: although the credit card companies did not directly violate any Western sanctions, they breached the spirit of the sanctions. Ceding to the request of the Russian authorities to transfer the traffic, both companies facilitated the circumvention of the US sanctions. Once the US financial institutions discovered deceptive practices employed in order to obfuscate Crimea-related transactions, the case started to border on sanctions evasion. In August 2015, OFAC issued a new clarification of the “misunderstood” nature of the embargo on US businesses, stating that: “The evasive practices identified by OFAC include the omission or obfuscation of references to Crimea and locations within Crimea in documentation underlying transactions involving U.S. persons or the United States. These practices apply to a range of activities involving both the financial services and international trade sectors.”¹¹⁵ OFAC stated that it had become aware of the seemingly

¹¹³ “BBC soobshchila o prekrashchenii vypuska kart Visa i MasterCard v Krymu,” *RBC*, 14 August 2018, <https://www.rbc.ru/finances/14/08/2018/5b7310769a7947c21493bc52>,

¹¹⁴ “Ne smeshite nashi magaziny. Kak obkhodiat sanktsii v Krymu,” *Novaia gazeta*, 31 January 2018.

¹¹⁵ US Department of the Treasury, “Crimea Sanctions Advisory. Obfuscation of Critical Information in Financial and Trade Transactions Involving the Crimean

established practice of omitting the originator or beneficiary address from SWIFT messages. These obfuscation patterns were viewed by OFAC as an activity aimed at circumventing sanctions compliance.¹¹⁶

Sanctions Avoidance Case I: Retail Companies

Context: despite the EU sanctions, the French and German supermarket chains Auchan and Metro Cash&Carry continue to carry out their business activities in Crimea. Their products are visible on the shelves of the two German and one French stores that remain in operation in Crimea. The goods are shipped via the Kerch port from the Russian mainland, despite the fact that it is prohibited for the EU companies to deal with this EU-sanctioned entity. Both companies seem to be aware of this and do not contest the fact that they are using the EU-blacklisted port for their delivery.¹¹⁷

In August 2017, the Ukrainian Prosecutor General's Office launched a criminal investigation of Auchan in connection to the latter's violation of the Ukrainian border. The criminal investigation was aimed at establishing whether the deliveries of goods carried out by the French company were in line with the Ukrainian legislation.¹¹⁸ However, the investigation had no legal consequences for the company.¹¹⁹

Technique: through the re-registration of their Crimean entities, both Metro Cash&Carry and Auchan were able to legally operate on the peninsula. According to the official documentation, the Metro stores in Crimea are owned by Moscow-based "Retail Property 5" LLC and "Retail Property 6" LLC. Ninety percent of the

Region of Ukraine," *OFAC*, 30 July 2015, https://www.treasury.gov/resource-center/sanctions/programs/documents/crimea_advisory.pdf.

¹¹⁶ *Ibid.*

¹¹⁷ Anton Zverev, Gleb Stolyarov, and Olga Sichkar, "Exclusive: How EU Firms Skirt Sanctions to Do Business in Crimea," *Reuters*, 21 September 2016, <https://www.reuters.com/article/us-ukraine-crisis-crimea-sanctions-insig/exclusive-how-e-u-firms-skirt-sanctions-to-do-business-in-crimea-idUSKCN1R1AN>.

¹¹⁸ "French Giants Auchan, Peugeot Face Prosecution in Ukraine over Work in Crimea," *TASS*, 28 April 2017, <http://tass.com/economy/943725>.

¹¹⁹ "Ne smeshite nashi magaziny."

latter belongs to Metro Group Retail Real Estate GmbH and ten percent to Metro Holding Properties GmbH. Both companies are registered in Germany. In the case of Auchan, there are even fewer layers in their corporate structure: registered in Russia, Auchan LLC belongs directly to its French parent company.¹²⁰

Both retail companies contract third-party transport companies to load up goods at distribution centers in southern Russia and then ship the trucks via ferry through the Kerch port. Later, the trucks disembark in Kerch and deliver the products to the stores in Crimea. The subcontractors are instructed not to use any sanctioned entities while delivering the goods to Crimea. However, it is not clear how the Russian subsidiaries monitor this.¹²¹

Justification: both retailers claim that they are not violating the EU sanctions, as their business activities in Crimea are conducted by Russian subsidiaries, which are not targeted. Auchan Holding's press office explained that the Russian retailers using the franchise are subject to Russian and not EU legislation. Antoine Pernod, senior vice-president for communication at Auchan Holding, justifies the company's decision to remain with the desire to alleviate the humanitarian situation there: "We have decided that we will continue to offer some vital products for the local population in Crimea, in particular foodstuffs, also we will not reduce the number of jobs."¹²² Similarly, Metro Cash&Carry argues that their business in Crimea is run by Russian subsidiaries which are not liable to EU sanctions. The parent company claims to be not involved in the local operational activities in Crimea and that most of the products come from Russian suppliers.¹²³

Legal assessment: this is a clear case of sanctions avoidance. According to EU sanctions, the export of goods to Crimea is limited to certain sectors, while Russian subsidiaries are not subjected to restrictive measures. This case illustrates that the EU sanctions are not fully comprehensive; certain activities are still legal under the

¹²⁰ Viktoriia Veselova, "Sekrety krupnogo biznesa: kak torguiut v Krymu Auchan i Metro," *Krym.Realii*, 10 October 2016, <https://ru.krymr.com/a/28044057.html>.

¹²¹ *Ibid.*

¹²² "Ne smeshite nashi magaziny."

¹²³ Zverev, Stolyarov, and Sichkar, "Exclusive: How EU Firms Skirt Sanctions."

sanctions regime. As an EU official acknowledged, the companies' business activities are in breach of the EU sanctions' spirit, but "in the absence of a trade embargo, there is always a fine line between compliance and non-compliance."¹²⁴ As the sanctions enforcement falls under the member states' regulations, it is for the German and French authorities to launch criminal investigations. However, no law suits are currently filed at the national levels.

Another loophole is the relationship between the parent company and the subcontractors. The transfer of goods to Crimea is a gray area, as the legal boundaries between the parent company and its subcontractor are hard to define.¹²⁵ In general, EU-based parent companies can be held liable "if they have instructed their local unit to act in violation of the sanctions," explained Artem Zhavoronkov, partner at law firm Dentons.¹²⁶ By creating complex corporate structures, both Metro Cash&Carry and Auchan intended to distance themselves from their Russian subsidiaries. With the re-registration of their businesses with Russian subcontractors, the German and French companies found a loophole in the EU sanctions regime that does not target Russian subsidiaries.

The way the German and French retailers justify their activities in Crimea is particularly interesting. The companies could have used the argument that selling foodstuffs in Crimea is not prohibited under the EU sanctions. However, as the goods are transported via a ferry that serves the EU-sanctioned Kerch port, the companies were in need of further justification, namely that it is the Russian subsidiaries that conduct business in Crimea. By distancing themselves, the German and French companies were able to shift the liabilities to their Russian counterparts (including for the violation of the Kerch port usage) and avoid the reputational risk associated with doing business in Crimea that could damage their international standing.

¹²⁴ *Ibid.*

¹²⁵ "Grauzone Krim-Sanktionen—Metro im Zweifel?", *Medianet*, 22 September 2016, <https://medianet.at/news/retail/grauzone-krim-sanktionen-metro-im-zweifel-10623.html>.

¹²⁶ Zverev, Stolyarov, and Sichkar, "Exclusive: How EU Firms Skirt Sanctions."

Sanctions Avoidance Case II: Car Dealers

Context: after the Crimea sanctions were put in place, Western automobile companies left the peninsula. However, soon afterwards, the media reported sightings on the streets of Crimea of new foreign cars by Volkswagen, Mercedes-Benz, Audi, BMW, Nissan, Peugeot, Toyota, Mitsubishi, and Kia Motors. In 2015–2016, it was revealed that the senior management of the “Crimean Federal University,” former Taurida National University, and the Prosecutor’s Office in Crimea had bought a Toyota Camry and a Toyota Land Cruiser for their own usage.¹²⁷ In 2018, it was reported that 15 Toyota Camry and 2 Mercedes-Benz had been subleased to the self-proclaimed Crimean government.¹²⁸ Ukraine’s Ministry of Foreign Affairs issued a statement condemning Western car dealers for violating the sanctions regime and appealed to the relevant authorities to take the necessary measures.¹²⁹ Legal procedures have been initiated against several German companies, including Volkswagen.¹³⁰

Technique: in July 2016, Crimea was officially incorporated into Russia’s Southern Federal District. This allowed foreign automobile companies to use their network of official dealer offices on the Russian mainland effectively in order to conduct business in Crimea. As the Ukrainian car dealers are no longer present in

¹²⁷ “Toyota Bypassing Sanctions to Sell Cars in Crimea,” *Hromadske International*, 20 July 2017, <https://en.hromadske.ua/posts/toyota-bypassing-sanctions-to-sell-cars-in-crimea>; and Aleksandr Alikin, “Krym prodolzhaet poluchat importnoe oborudovanie v obkhod sanktsii,” *Eurasianet*, 21 February 2017, <https://russian.eurasianet.org/node/65154>.

¹²⁸ Viktoriia Veselova, “Sanktsionnyi avtopark’: kak pravitelstvo Kryma zakupaet vonye inomarki,” *Krym.Realii*, 23 January 2018, <https://ru.krymr.com/a/28992306.html>.

¹²⁹ Ministerstvo z pytan tymchasovo okupovannykh terytorii Ukrainy ta vnutrishnio peremishchenykh osib Ukrainy, “Vyivneno fakty vykorystannia tovgovykh marok avtomobilnykh brendiv na tymchasovo okupovanii terytorii Ukrainy,” 27 December 2017, https://mtot.gov.ua/fakty_vykorystannia_torgovyh_marok.

¹³⁰ Matthias Beermann, “Moskau ist an einer Lösung nicht interessiert,” *Rheinische Post Online*, 2 February 2018, https://rp-online.de/politik/ausland/ukrainischer-aussenminister-pawlo-klimkin-moskau-ist-an-einer-loesung-nicht-interessiert_aid-18877381.

Crimea, the car brands were delivered via sublease from Russia's nearest cities such as Krasnodar, Novorossiisk, and Nizhnii Novgorod. The financial partners in wire-transactions are the Russian banks operating in Crimea—Genbank and RNKB. While the vehicles are bought from the mainland in Russia, the technical services are performed in official distribution offices in Krasnodar.¹³¹ Another technique used was to deliver the vehicle direct from the EU. Using a series of Russian and Austrian middlemen, Skoda Octavias were shipped to Crimea via the Kerch port without any legal repercussions.¹³²

Justification: Western car manufacturers are unanimous in claiming that they have not violated the sanctions regime and that they have no official representation in Crimea. Natalia Kostyukovitch, communications officer at Volkswagen Group Russia, denied allegations that the company had circumvented the prohibitions.¹³³ Daimler acknowledged that it knows about the existence of gray dealers in Crimea, but claimed to have no control over them.¹³⁴ Nevertheless, the companies do not seem entirely comfortable with their own justification that implies that they are conducting their business as usual in Crimea and have also come up with other explanations—Volkswagen, for example, explained their presence in Crimea on the grounds that the company cares about their clients' needs.¹³⁵

¹³¹ "Ukraina nakonets uvidela v Krymu importnye mashiny," *Kommersant*, 27 December 2017, <https://www.kommersant.ru/doc/3511778?query=крым%20санкции>.

¹³² Viktoriia Veselova, "V 'ob'ezd' sanktsii: kak inostrannye avtomobili popadauiut v Krym," *Krym.Realii*, 21 December 2017, <https://ru.krymr.com/a/28931769.html>.

¹³³ Andrey Gurkov, "Wie der Verkauf deutscher Pkw auf der Krim weitergeht," *Deutsche Welle*, 4 May 2017, <https://www.dw.com/de/wie-der-verkauf-deutscher-pkw-auf-der-krim-weitergeht/a-38687520>.

¹³⁴ "Ukraina nakonets uvidela v Krymu importnye mashiny," *Kommersant*, 27 December 2017, <https://www.kommersant.ru/doc/3511778?query=крым%20санкции>.

¹³⁵ Denis Trubetskoy, "Mit Krim oder ohne?" *Zeit Online*, 8 January 2016, <https://www.zeit.de/wirtschaft/2016-01/ukraine-boycott-coca-cola-russland-karte-krim>.

Legal assessment: the European export ban is not comprehensive and is restricted to the three key sectors of transport, telecommunications, and energy. Although the media reports labeled the case as a violation of EU sanctions, a closer look at the legal provisions nullifies this accusation. According to Annex II of the EU Council Decision 692/2014, the EU prohibited the delivery of vehicles that are suitable for ten or more people or special-needs vehicles such as wreckers or cranes.¹³⁶ The delivery of passenger automobiles is not included on the list and thus does not constitute an illegal activity. Juxtaposing companies' justification and the legal framework, it is interesting to observe that the companies do not openly acknowledge this loophole. Instead of directly referring to the Annex II in the EU legislation, the car manufacturers use other excuses such as client needs or the lack of control over gray dealers. This strongly underlines the fact that it is a high-risk activity for companies to conduct business as usual in Crimea. The companies evidently fear that by acknowledging their presence they will suffer reputational damage. In fact, after the Siemens scandal, Volkswagen sent a letter to its Russian car dealers, reminding them about the imperative to comply with the EU sanctions and specifying that the sale of trucks, commercial cars, and specialized vehicles is strictly prohibited.¹³⁷

Under the current sanctions regime, this case represents an instance of sanctions avoidance. By exploiting the loophole in the sanctions regime and by bringing vehicles to Crimea from Russia without any Ukrainian authorization or Ukrainian customs registration, the Western companies *de facto* treat Crimea as part of Russia. This clearly contravenes the EU's non-recognition policy and breaches the spirit of the sanctions.

¹³⁶ Annex II, Council Regulation (EU) No 1351/2014 (18 December 2014) amending Regulation (EU) No 692/2014.

¹³⁷ Andrei Zagorskii, "Volkswagen razoslal pis'mo na pamiat'," *Kommersant*, 11 October 2017, <https://www.kommersant.ru/doc/3435561>.

Conclusion and Recommendations

Sanctions-busting behavior can be explained by companies' fundamental commercial interests. While the private sector bears the main costs of sanctions compliance, it has a strong economic motivation to avoid or evade sanctions in order to maintain its share of the Russian market. Although the Siemens case illustrated the importance of due diligence and the risks a foreign company faces when dealing with Russia directly or via local subsidiaries, the number of cases of sanctions circumvention has not decreased.

As this article has demonstrated, Western firms have employed various techniques to bypass the Crimea sanctions. The complex sanctions regime allowed them to exploit the loopholes within the sanctions framework and jurisdictions to lessen their exposure to compliance. First, Western companies used the get-out clause, by showing that they conducted due diligence. Ironically, due diligence was used as a convenient instrument for disclosing information while simultaneously suppressing information that could be harmful for companies. Stating that they had no reason to suspect that their activity would lead to a sanctions breach, companies claimed to be unaware of the true identity of the end user or the end destination, thus using the due diligence as proof of innocence. The second loophole was the re-registering of assets to Russian subsidiaries. As the latter is not covered by sanctions, Western firms created complex corporate structures or used intermediaries to distance themselves from their Russian entities. Despite the fact that those complex corporate structures have been revealed by investigative journalism, so far there are no legal consequences for the entities involved. Finally, the third loophole is the ability to operate on Russian territory. By claiming that they conducted activities in Russia and not in Crimea, companies argued that their activities are not subject to sanctions. Interestingly, none of the companies referred to the legal loopholes within the sanctions regime. Instead, companies used more complex justifications to distance themselves and to avoid the reputational risks.

The majority of the cases fall under the category of sanctions avoision, as the boundaries between law-abiding and law-breaking

activities are blurred. Some cases constitute avoidance with elements of evasive practices (for example, the cases of the shipping and credit card companies), while other cases transgress into evasion in the process or are interspersed with such evasion (as in the cases of the bridge constructors). The absence of clear-cut sanctions evasion cases points to the amount of “creative compliance” that companies engage in so as to continue business as usual in Crimea. Many of them belong to global economic elites—they are large companies and corporations which employ professional services to exploit the letter of the law in order to stay within the legal brackets. They arrange their affairs so as to ensure compliance in form but not in substance. As a result, the spirit of the sanctions is breached, and their credibility and effectiveness is undermined.

The analysis of sanctions-busting points to ways in which the effectiveness of Western sanctions can be enhanced. First, staying agile and flexible will be the US’ and EU’s best response to countering sanctions-busting. Both actors should address the loopholes in their sanctions framework and prevent the emergence of new ones. Both should strengthen their leverage by anticipating how quickly and easily their sanctions might be evaded and avoided and include appropriate counter-measures at the design stage. In preventing sanctions-busting, systemic thinking is crucial. In contrast to targeting separate sectors and entities, whole systems and networks should be sanctioned. As suggested by Ukraine’s Ministry of Foreign Affairs, to curtail the sanctions circumvention, the Crimea sanctions should be expanded to Russia’s Southern Federal District where the majority of evasive practices takes place.

Second, the monitoring and enforcement mechanisms both in the West and in Ukraine should be significantly improved. The EU member states’ and Ukrainian governments, in particular, clearly lack the political will to enforce sanctions effectively. For the EU, the costs of monitoring are high and time-consuming, while the value of illegal export-import is low.¹³⁸ For Ukraine, the implementation of full-scale sanctions would disrupt the business

¹³⁸ Lloyd’s List, “Out of Sight, Out of Mind,” 14.

structures of rent-seeking elites. So far, no US or EU companies implicated in sanctions breaches have been prosecuted, while the Criminal Code of Ukraine still lacks provisions on sanctions.¹³⁹ Borrowing experience from the North Korean case, a UN Panel of Experts would be helpful in early detection and effective countering of the sanctions-busting schemes. Prosecuting the sanctions evaders could repair the damage done to the credibility of Western sanctions and would deter companies from breaching them in the future.

Finally, better communication between the private and the public sectors is crucial, as is clear guidance from the authorities on implementation requirements. As suggested in the RUSI report, public-private partnerships will be quintessential for the enhancement of companies' compliance and thus sanctions' effectiveness. Moving from reactive and one-directional communication, an exchange between private businesses and government authorities at the early stages—during design and implementation—will be crucial for discussing the ways in which unintentional consequences can be avoided and alternative solutions forged. Although sanctions are first and foremost a foreign policy tool, business-government interaction can serve to enhance the understanding of the sanctions regime and its weak spots, and to enable the sharing of experience on best practice.¹⁴⁰

¹³⁹ Oleksandr Humeniuk, Maksym Kytsiuk, Olena Loginova and Andrii Ianitskyi, "International Trade with Crimea Ongoing Despite Sanctions," *Organized Crime and Corruption Reporting Project*, 15 August 2015.

¹⁴⁰ Keatinge, Dall, Tabrizi and Lain, "Transatlantic (Mis)alignment," 13–14.

