

Russian oil price cap takes effect

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As the G-7 price cap on seaborne Russian oil takes effect, we provide an overview of OFAC's guidance, which establishes a safe harbor for U.S. service providers that comply with due diligence, attestation, and recordkeeping requirements.

On November 22, 2022, the United States Department of the Treasury's Office of Foreign Asset Controls (OFAC) published a determination (the "Treasury Determination") and issued related guidance pursuant to Executive Order 14071¹ setting out the framework it will use to implement the price cap policy for crude oil of Russian Federation origin ("Russian oil") in coordination with an international coalition, including the G7, the European Union, and Australia (the "Price Cap Coalition").² Other members of the Price Cap Coalition have also taken steps to implement the price cap policy under their respective domestic authorities, with a goal of consistent implementation and enforcement within the coalition.³ The Treasury Determination prohibits U.S. persons from providing certain services related to the maritime transport of Russian oil (the "Covered Services") but authorizes the provision of Covered Services in connection with Russian oil that is purchased at or below a certain price (the "price cap"). OFAC published an additional determination on December 5 setting the initial level of the price cap at \$60, following a last-minute agreement among EU member states on that level.⁴ An additional price cap on Russian origin petroleum products is expected to be implemented in early 2023 and will be addressed in future OFAC guidance.

The price cap policy is an attempt by the United States and its partners to limit the revenue the Russian government earns from oil sales while avoiding the disruption to global energy markets that would be caused by outright bans on the purchase or transportation of Russian oil. The mechanism created to implement and enforce the price cap is complex, and OFAC, through its guidance, has attempted to outline clear compliance and due diligence expectations for oil market participants and financial institutions. Notably, OFAC has taken the unusual step of offering an actual safe harbor from enforcement for those who act in accordance with those expectations. While this guidance is helpful, market participants who choose to continue to participate in transactions involving seaborne Russian oil will need to attend closely to their due diligence obligations and be mindful of red flags that may indicate attempts to circumvent the price cap policy.

We provide below a summary of the price cap enforcement mechanism established by the Treasury Determination, OFAC's due diligence guidance and safe harbor process, and certain limited exceptions to the price cap and general licenses issued by OFAC.

Overview of the price cap mechanism

As noted, the price cap is implemented under U.S. law through the Treasury Determination, which broadly prohibits the exportation, reexportation, sale, or supply of Covered Services from the United States or by U.S. persons to any person in the Russian Federation. The Treasury Determination, however, authorizes such services where provided in connection with the maritime transportation of Russian oil whose price does not exceed the price cap.⁵

For purposes of the Treasury Determination, Covered Services include the following categories of services, in each case where provided in relation to the maritime transport of Russian oil:

- *Trading/commodities brokering.* Buying, selling, or trading commodities and/or brokering the sale, purchase, or trade of commodities on behalf of other buyers or sellers.

- *Shipping*. Owning or operating a ship for the purpose of carrying or delivering cargo and/or freight transportation; chartering or sub-chartering ships to deliver cargo or transport freight; brokering between shipowners and charterers; and serving as a shipping/vessel agent.
- *Insurance*. The provision of insurance, reinsurance, or protection and indemnity (P&I) services; satisfying claims related to underwriting insurance policies that protect policyholders against losses that may occur as a result of property damage or liability; assuming all or part of the risk associated with existing insurance policies originally underwritten by other insurance carriers, including the reinsurance of a non-U.S. insurance carrier by a U.S. person; and liability insurance for maritime liability risks associated with the operation of a vessel, including cargo, hull, vessel, P&I, and charterer's liability.
- *Flagging*. Registering or maintain the registration of a vessel with a country's national registry of vessels. This does not include the deflagging of vessels transporting Russian oil sold above the price cap.
- *Customs brokering*. Assisting importers and exporters in meeting requirements governing imports and exports. This does not include legal services or assisting importers and exporters in meeting the requirements of U.S. sanctions.
- *Financing*. A commitment for the provision or disbursement of any debt, equity, funds, or economic resources, including grants, loans, guarantees, suretyships, bonds, letters of credit, supplier credits, buyer credits, and import or export advances.
 - This does not include the processing, clearing, or sending of payments by banks where the bank (1) is operating solely as an intermediary and (2) does not have any direct relationship with the person providing services related to the maritime transport of the Russian oil (i.e., the person is a non-account party) as it related to the transaction. Thus, this determination does not impose any new prohibitions or requirements related to the processing, clearing, or sending of payments by intermediary banks.
 - Financing also does not include services with respect to foreign exchange transactions and the clearing of commodities futures contracts.

OFAC's guidance makes clear that the following categories of services are not considered Covered Services: medical evacuation or other emergency services for crew members; health, travel, or liability insurance for crew members; and classification, inspection, bunkering, and pilotage.

The Treasury Determination's authorization of the provision of Covered Services in connection with sales of Russian oil that are consistent with the price cap policy applies with respect to the provision of services by U.S. persons or from the United States in connection with the importation of Russian oil into third countries. The Treasury Determination does *not* override the separate prohibition on the importation of Russian oil and petroleum products into the United States under Executive Order 14066. Nor does it authorize transactions involving blocked persons, though General License 8D separately authorizes the involvement of certain blocked Russian financial institutions, or the Russian Central Bank, in energy-related transactions, which could include the provision of Covered Services consistent with the price cap policy.

The price cap applies from the embarkment of maritime transport of Russian oil through the first landed sale in a jurisdiction other than the Russian Federation. Once the Russian oil has cleared customs in a jurisdiction other than the Russian Federation, the price cap does not apply to any further *onshore* sale, but it would still apply in cases where the Russian oil is taken back onto the water without being substantially transformed.⁶

The price cap only applies to Russian oil, i.e., crude oil (as defined at Harmonized Tariff Schedule of the United States subheading 2709.00) of Russian Federation origin. In determining whether crude oil is Russian oil, OFAC's guidance states that it is generally reasonable to rely on a certificate of origin, but that providers of Covered Services should exercise caution if they have reason to believe such certificate has been falsified or is otherwise erroneous.

Consistent with this broader guidance, OFAC notes that crude oil which merely transits through a pipeline in Russia, and is accompanied by an appropriate non-Russian certificate of origin, would not be considered Russian oil. This appears intended to provide specific comfort with respect to Kazakh origin oil transported through the Caspian Pipeline Consortium or the Atyrau-Samara pipelines, consistent with prior OFAC guidance indicating that such oil is not subject to the energy import restrictions under Executive Order 14066.⁷ Similarly, OFAC would not consider crude oil to be of Russian origin solely because it contains a de minimis amount of crude oil left over from a container or tank (e.g., a "tank heel," or unpumpable quantity of substance that cannot be removed from the container without causing damage to the container).

Subsequent adjustments to the initial \$60 price cap will be communicated through revisions to the Treasury Determination that will be published in the Federal Register and on OFAC's website. The price cap took effect at 12:01 a.m. eastern standard time on December 5.

Guidance on the safe harbor

The price cap guidance establishes a safe harbor for providers of Covered Services who comply in good faith with a recordkeeping and attestation process so that each party in the supply chain of Russian oil shipped via maritime transport demonstrates or confirms that the Russian oil was purchased pursuant to the price cap. Relevant records must be retained for five years. The safe harbor is designed to shield such service providers from strict liability for breach of sanctions in cases where service providers inadvertently deal in the purchase of Russian oil sold above the relevant price cap owing to falsified or erroneous records provided by those who act in bad faith or make material representations.

OFAC divides Covered Service providers into three tiers of actors, each of which must comply with differing due diligence and recordkeeping obligations to be afforded the safe harbor as described below:

- *Tier 1 actors.* Actors who regularly have direct access to price information in the ordinary course of business, such as commodities brokers and oil traders. To be afforded the safe harbor, Tier 1 Actors must retain documents showing that Russian oil was purchased at or below the relevant price cap. Such documentation may include invoices, contracts, or receipts/proof of payment.
- *Tier 2 actors.* Actors who are sometimes able to request and receive price information from their customers in the ordinary course of business, such as financial institutions, ship/vessel agents, and customs brokers. To be afforded the safe harbor, Tier 2 Actors must, to the extent practicable, request and retain documents that show that Russian oil was purchased at or below the relevant price cap. When not practicable to request and receive such information, Tier 2 Actors must obtain and retain customer attestations, in which the customer commits that for the service being provided, the Russian oil was purchased or will be purchased at or below the relevant price cap. OFAC notes that whether it is practicable to obtain price information will depend on what is reasonable and customary in the ordinary course of business based on the actor's relationship with its customer. This may change depending on context. For example, OFAC notes that financial institutions providing transaction-specific trade finance routinely collect trade documentation to manage financial and compliance risks and thus would be expected to obtain price information where they are able to do so, but that providers of general purpose financing would typically be expected to rely on customer attestations. Similarly, OFAC notes that the ability of ship/vessel agents to obtain price information in the ordinary course will depend on whose interest the agent is representing.
- *Tier 3 actors.* Actors who do not regularly have direct access to price information in the ordinary course of business, such as insurers, P&I clubs, shipowners, and flagging registries. To be afforded the safe harbor, Tier 3 Actors must obtain and retain customer attestations, in which the customer commits that for the service being provided, the Russian oil was purchased or will be purchased at or below the relevant price cap. Alternatively, in the case of insurers and registries, reliance on existing sanctions exclusion clauses⁸ or other existing contractual sanctions compliance provisions will be deemed sufficient to bring the actor within the scope of the safe harbor.

In cases where attestations are required, OFAC does not require any particular form or language, but its guidance does provide examples of language that OFAC would consider appropriate. In all cases, OFAC notes that failure to provide a requested attestation or reasonably requested price information should be considered a red flag requiring either further inquiry or rejection of the potentially evasive transaction and reporting to OFAC.

While explicitly styled as a “safe harbor,” the enforcement policy does contain standard warning language that reliance on information or attestations provided by customers or other parties may not wholly shield Covered Service providers from liability if the service provider knows or has reason to know that such information or attestation is false. The guidance reinforces the obligation to conduct reasonable due diligence and be attentive to red flags. While OFAC will undoubtedly focus its enforcement efforts on deliberate bad actors as stated in its guidance, the line between inadvertence and reason to know is not always clear, and the safe harbor does not provide full comfort to Covered Service providers who may find themselves in this grey area. Additionally, while other members of the Price Cap Coalition are expected to implement similar due diligence and safe harbor policies under their respective domestic authorities, there is no guarantee that they will be fully aligned in letter or in practice, and Covered Service providers operating in multiple jurisdictions will need to be mindful of potential variations.

Exceptions

While the price cap went into effect at 12:01 a.m. Eastern Standard Time on December 5, the Treasury Determination provides that it will not apply to any Russian oil that has been loaded onto a vessel at the port of loading prior to that date and time, so long as it is unloaded at the port of destination prior to 12:01 a.m. eastern standard time on January 19, 2023. OFAC also signaled in its guidance that it intends to make similar allowances for in-process shipments in the event that the price cap is adjusted in the future.

Additionally, OFAC issued two time-limited general licenses authorizing the provision of Covered Services in connection with importation of Russian oil into Japan and certain EU member states.⁹ These general licenses reflect the coordinated multilateral nature of the price cap policy and efforts to minimize the impact of the policy on energy security of members of the Price Cap Coalition. OFAC also issued a third general license authorizing the provision of limited Covered Services where needed to address vessel emergencies.¹⁰

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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- ¹ We discuss Executive Order 14071 in the following [client update](#) and related FAQs in the following [client update](#).
- ² U.S. Department of the Treasury, Determination Pursuant to Section 1(a)(ii) of Executive Order 14071 (November 21, 2022), available at https://home.treasury.gov/system/files/126/determination_11222022_eo14071.pdf; see also OFAC, OFAC Guidance on Implementation of the Price Cap Policy for Crude Oil of Russian Federation Origin (November 22, 2022), available at https://home.treasury.gov/system/files/126/price_cap_policy_guidance_11222022.pdf.
- ³ See, e.g., HM Treasury, UK Maritime Services Prohibition and Oil Price Cap Guidance (November 2022), available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1121744/Russian_Oil_Services_Ban_-_HMT_Industry_Guidance.pdf
- ⁴ U.S. Department of the Treasury, Determination Pursuant to Section 1(a)(ii) of Executive Order 14071, available at https://home.treasury.gov/system/files/126/20221205_Price_cap_determination.pdf.
- ⁵ In assessing whether the price of Russian oil is at or under the price cap, OFAC's guidance provides that shipping, freight, customs, and insurance costs are not included in the price cap, so long as those costs are separately invoiced and commercially reasonable. OFAC cautions, however, that commercially *unreasonable* costs for such services may be a red flag indicating an attempt to circumvent the price cap.
- ⁶ Refining of crude oil results in substantial transformation that takes the ensuing refined product outside the scope of the price cap policy. However, blending crude oils is not considered substantial transformation.
- ⁷ See OFAC Responses to Frequently Asked Questions, FAQ 1020 (March 18, 2022), available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1020>.
- ⁸ The guidance notes in particular that use of the standard sanctions exclusion clause language described in OFAC's FAQ 102 is sufficient for insurers, reinsurers, and P&I clubs to be covered by the safe harbor, though additional specific attestations or clauses relating to the price cap may be requested if the Covered Service provider considers them helpful.
- ⁹ See General License 55, available at https://home.treasury.gov/system/files/126/russia_gl55.pdf (authorizing Covered Services in connection with the importation into Japan of Russian oil from the Sakhalin-2 project until September 30, 2022); General License 56, available at https://home.treasury.gov/system/files/126/russia_gl56.pdf (authorizing Covered Services in connection with importation into EU members states that have been granted derogations from the EU regulation implementing the price cap policy).
- ¹⁰ See General License 57, available at https://home.treasury.gov/system/files/126/russia_gl57.pdf.