Center for Strategic and International Studies

"Are Sanctions Working?"

Sanctions and the Energy Sector

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STEPHANIE SEGAL: (Off mic) – to a bit more of the specificity. I think we've had the benefit of hearing the official sector perspective from Undersecretary Mandelker. We have heard various perspectives based on the regions that we're talking about, as far as the effectiveness of sanctions and achieving certain foreign policy objectives. This panel is very much focused on sanctions and the energy sector. So let me do some brief introductions and then turn it over to the experts here.

I have immediately to my left Peter Flanagan is a partner at Covington & Burling, where he councils clients on broad range of compliance requirements affecting international trade and investment including, of course, sanctions. Next to Peter, we have Kevin Book, who is managing director at ClearView Energy Partners, where he head the research team covering oil, gas and coal policy. Kevin is also a senior associate with CSIS' national energy – excuse me – Energy and National Security Program. And then you've met Sarah already. Sarah is CSIS senior vice president and also director of the Energy and National Security Program, where she leads the center's work in energy policy, market, and technology analysis.

So here we have the expertise to focus explicitly on sanctions and the energy sector. And what I'd like to do is start with Peter, who was kind enough, I think, to provide some visual aids to really – I think it both illustrates and will help us better understand the complexity of the sanctions issue. But, Peter, as you walk through the slides that I hope will appear here, it would be helpful to kind of understand the legal underpinnings for the various sanctions regimes, and any distinctions you want to pull out based on the countries that we're talking about or based on things like primary versus secondary sanctions. I think that would be a helpful introduction.

PETER L. FLANAGAN: Sure. Sure. Thanks. It's been a – I think it's been a terrific discussion so far. Undersecretary Mandelker I think gave us a vision of where the administration is going, and cited the many tools, the many ways in which sanctions are implemented. And for those of us who think about sanctions every day, it has become incredibly complex. We have, you know, networks of primary sanctions, secondary sanctions, comprehensive sanctions, sectoral sanctions. And these are implemented under statutes, where Congress has gotten into the act, as the last panel discussed, through executive orders, through implementing regulation, policy statements, FAQ guidance.

It's quite a lot for energy companies to try to navigate as they run their day-to-day business. These are strict and important prohibitions that they need to understand and to implement in their business activities. And there are multiple agencies involved. We've talked about the Treasury Department, but obviously the State Department has important authorities for purposes of secondary sanctions. And the Commerce Department has complementary controls with respect to movements of U.S.-origin goods and technologies. So there are multiple agencies, multiple authorities. And what I thought I might do just briefly as we think about the landscape for international energy companies is to tick through the same three programs that the last panel did such a nice job of discussing, and to highlight the kinds of sanctions that companies need to deal with – first with respect to Iran, and then Russia, and then Venezuela briefly.

And what I wanted to flag is just this – just this differentiation between primary sanctions and secondary sanctions, because what we have seen in this administration – I think more so than any of the period in the 25 years that I've been working on sanctions, is the use – the affirmative use of secondary sanctions as a tool. Primary sanctions, the prohibitions on U.S. persons and U.S. companies, and

anybody who's dealing in U.S. goods and technology, those are pretty well-known and pretty identifiable as to what the dos and the don'ts are. When you get into secondary sanctions, companies don't violate secondary sanctions, but they put at risk their ability to do business in U.S. markets if they act in ways that are inconsistent with U.S. policy. They don't require a U.S. nexus to run afoul of secondary sanctions.

In the case of Iran, the secondary sanctions that have been snapped back since the U.S. left the JCPOA have been most significant for international energy markets. And they really do affect the full sweep of the energy sector activities. So with respect to Iran, there are both mandatory, quote/unquote, "secondary sanctions," pursuant to statute, and also discretionary secondary sanctions that the administration can choose to implement when companies – non-U.S. companies are involved in upstream investments in Iran's energy sector or providing any kind of support for the production of petroleum resources in Iran.

But then it ticks through the full range of the supply chain. So the purchase and acquisition of petroleum products, transporting Iranian crude, which has been a real focus of recent action by the administration. Dealing with Iran's port operators, their shipping and shipbuilding sectors, and also dealing with parties that the U.S. has put on the blacklist, the Treasury Department's SDN list, for violating various aspects of the sanctions. Just that act alone can trigger exposure to secondary sanctions. So it's quite a sweep of secondary sanctions authorities, all of which are backed up by measures targeting international financial institutions, which really are the first line of defense and the means by which the administration, I think, is able to bring muscle to the implementation of secondary sanctions.

So switching to Russia, I think Jeff did a really nice job in the last panel of highlighting some of the tools that are being used. And here, again, there are both primary and secondary sanctions that energy companies have to navigate. And the primary sanctions operate really at three levels. The most comprehensive primary sanctions, those that affect U.S. persons and U.S. companies – U.S. energy companies – target dealings with Russian SDNs and also Crimea, which is effectively subject to a full embargo.

The second layer of primary sanctions are the sectoral sanctions that OFAC administers. And these are the measures that are really targeted at unconventional oil and gas activities in Russia, or projects around the world where Russia has a substantial interest. So Arctic offshore, deep water and shale, these are the projects that have been targeted by sectoral sanctions. And also, as the last panel noted, the extension of credit to Russian energy companies. And, third, we have export controls that reinforce sectoral sanctions by restricting the flow of U.S. origin goods and technology to certain companies and certain kinds of energy projects. So it's a – it's a very targeted, nuanced set of controls at the unconventional oil and gas sector.

The secondary sanctions are mostly an outgrowth of CAATSA, adopted, you know, the fall after President Trump was elected. And these have a broad sweep. They target significant investments in special Russian crude oil projects, the development of energy export pipelines . And here, it's really Nord Stream 2 was the main target. And early on the administration – we could talk about this – expressed a willingness to work with allies. But they're – I think are stepping back somewhat. Kevin will probably get into this – stepping back from an earlier articulate of how they might exercise their secondary sanctions authorities. And, third, are significant transactions with the Russian defense and intelligence sector. So there's a broad authority with respect to secondary sanctions that energy companies have to navigate.

And finally, with respect to Venezuela, Moises did a – I think a great job in his introductory remarks to summarize the toolbox. But here too we have a mix of comprehensive, sectoral, and secondary sanctions. The most comprehensive sanctions target PDVSA, pursuant to executive order, and also officials in the Maduro government, as Moises explained. But that list has been growing to reach state-owned banks, shipping companies. These are really full-scale prohibitions. The sectoral sanctions, which are not comprehensive, but which reach debt and equity measures, really target the rest of the government of Venezuela, to make it difficult, as Moises explained, for the Venezuelan government to raise credit in international markets.

As Undersecretary Mandelker indicated, the government has the ability to authorize activities through general licenses. And in Venezuela, this has been a real tool. The general licenses that have authorized dealings with CITGO in the United States, Nynas in Europe, the general license that was just recently extended for three more months to authorize Chevron and a number of other U.S. companies to support assets in Venezuela, looking forward to a day when perhaps a new government is going to inherit those oil and gas assets. Trying to manage those authorities and think about sanctions tools as supporting a transition in government.

The area that's been, I think, most complicated for energy companies is to think about how these secondary sanctions might be utilized with – under Venezuela sanctions, because there have been some targeted use of the secondary sanctions authorities pursuant to executive order to block the assets of companies that have been supporting the trade between Venezuela and Cuba. Most notably, PB Tankers of Italy, who found itself on the SDN list until just recently. But a number of other international companies have long-standing projects in Venezuela, dealings with PDVSA that are at risk of potentially being targeted if the administration decides to ratchet up secondary sanctions. So this is an area of real uncertainty and risk for international energy companies as they think about how they chart their course in these various programs.

MS. SEGAL: Great introduction. Actually leads to a whole lot of second- and third-round questions that I want to come back to. Before we do that, Kevin, I'd like to turn to you and maybe have you frame this in the context of overall energy sector developments – kind of global energy sector developments, and how we should think of sanctions in light of what's happening globally in energy markets.

KEVIN BOOK: Sure, Stephanie. Thank you. Thank you, Sarah. Thank you CSIS for having me. What a great couple of panels we had.

We got from the Treasury Department mention of a toolkit. And from Peter, we've actually seen the toolkit. So now you can inspect it. I think I'll maybe talk a little bit about how the tools are used, and where it meets sort of the interesting part of the discussion for energy people, which is how many barrels come off the market. What does it do to price? Where is the – where is the change investment expectations?

But let me start first with the context. The Russia toolkit that Peter just described was essentially created after the Ukraine incursion. And it was created in a time of high prices. A real oil price in today's dollars of more than $100 a barrel – $115-$120 a barrel. And so it targeted future oil. When we look at the Venezuela and Iran actions that were taken, those actions were taken at a time of considerably lower crude prices. That gives more latitude when you consider that the targets of these sanctions are producer nations – producer nations of size, right? Venezuela, Iran, and Russia. An

unthinkable thing to be targeting all three producer nations with sanctions at $100 a barrel. But not only thinkable, happening today.

The second thing I would say about that, and it's important, is that even if they don't sound like oil sanctions necessarily, I mean, this stuff is extraordinary complicated to the practitioner. To the layperson, I think it can be very intimidating. Primary, secondary, sectoral, what? The question is, what does it do to the investment in oil and gas? What does it do to supply? What does it do to the buyers of that oil and gas? What does it do to demand? And when you get right down to it, financial sanctions can be energy sanctions very easily, because it takes money to get resources – conventional resources or renewable resources – installed, or produced, or out of the ground. So limit a country – a producer country that owns its producers access to capital, to credit, and you will have an effect on at least the allocation resources within the country, if not a direct impact on production.

Now, with regard to the Iran and Venezuela sanctions, the Iran sanctions mechanism that Peter described, and that we heard so much about already, is really about acting on the demand side, acting on the actors who purchased oil from Iran. We haven't been purchasing oil from Iran for decades. So that's not the issue – nor oil products, nor much of anything else. But that mechanism is pretty effective. And if you look at where Iran's exports were a little over a year ago, at 2 ½ million per day.

It depends on who's numbers you're going to use. There's a lot of uncertainty, given the number of ships that are traveling without AIS signatures on the open waters and ship-to-ship transfers that are happening under cover of night. One aspect of sanctions is that the increased use of sanctions, as Secretary Mandelker pointed out, produces an increased use of countermeasures by those who wish to avoid sanctions. But be it as it may, you're looking at something like an 85 percent reduction in total volumes, thereabouts, of total export volumes for Iran.

For Venezuela, the mechanism is really both on the demand side – the U.S. was a big buyer of heavy oil – but also somewhat on the supply side, the investment that could go into the ground so that PDVSA could produce. And these things are distinct and different. They're market specific. They're circumstances specific. And in many cases, they're entity specific – given the interests of U.S. or allied countries companies that are going to be operating in concert with each of these producer nations.

And as we're sitting here right now – it turns out this is not just a well-timed discussion; it is an incredibly well-timed discussion – (laughter) – because the Protecting Europe's Energy Security Act is a – last I checked on my iPhone before I came up here is being voted on by the Senate Foreign Relations Committee right now. And this is an interesting measure, because it's one of our pending sanctions bills targeting Russia. You think of sort of the Venezuela picture is about halfway full – there's still a few more things that could be done, as Peter mentioned, with secondary sanctions authority. And Iran is ramped up to the max. Russia is still, because of that lease that was given on sort of the future oil being targeted not the present oil, there's still a lot of things to be targeted. But the Nord Stream 2 pipeline, which is the purpose of the PEESA, the Protecting Europe's Energy Security Act, and the TurkStream pipeline are the things being discussed right now.

And this is complicated, because like CAATSA, the Countering America's Adversaries Through Sanctions Act of 2017, the secondary nature of the sanctions contemplated could impact European countries. And there's many questions about whether the Russian sanctions regime that will be brought to bear will invest the investors, affect OMV, and Shell, and other companies that are financing the construction of the pipeline. But it's only one of four packages that are pending. There's another one called ESCAPE. Don't ask me to spell out all of the acronyms. They're very creative,

though. I give compliments to those who did it. (Laughter.) But ESCAPE is essentially another pipeline targeting bill that also liberalizes U.S. LNG exports. And the substitution quid pro quo is pretty straightforward.

There are two broader-reaching measures though – one that would essentially plow through that 33 percent safe harbor in Directive 4 that Peter mentioned, which – DASKA, defending against Kremlin – oh, I can't do it. (Laughter.) And there's another one called DETER. And those two are much more broad reaching. They could affect not just the oil and gas infrastructure projects, but the producing projects. So essentially not just the midstream but also the upstream. And the ability of U.S. oil companies, not just European gas consumers, to interact with Russia.

So we're at the threshold of all that right now, right? By the time this panel is done, that bill will have moved or not and we'll have more to say about it. But I'll stop there with, again, just a reminder that this is context sensitive. Price matters. And there's mechanisms that are used in different places in different ways based on circumstances. And not to be overlooked, money goes into the ground so that oil can come out. So sanctions on money are energy sanctions when you're sanctioning producer nations.

MS. SEGAL: Thanks. Yeah, I will say, I agree with you on the timely comment. But given kind of the pace of activity over the last few years we had pretty good odds of being particularly timely on this topic.

Sarah, I'm going to – I'm going to ask you kind of a similar question to Kevin because, you know, sanctions is part of what you look at, but you really are thinking about kind of energy sector more broadly, and obviously kind of the strategic implications of energy sector developments. So could you talk to how you see sanctions impacting energy markets, and even maybe a strategic view on energy markets in light of sanctions activity?

SARAH LADISLAW: Sure. Yeah, no, thanks very much. I'm always really super happy. Peter does an amazing job of going over an exceedingly complex issue very quickly. It looked like a photoshoot out here looking at your slides. So people are really happy to absorb that.

I mean, I think Kevin did an excellent job of talking about the way in which the current sanctions regimes are affecting behavior. I think, as you point out, you know, the first time that we wrote on this topic in particular was back in, I think, 2011. And it was pretty evident that we had sort of an emerging sanctions regime on Iran, and then a lot of it was being done in the context of the idea that the U.S. was now sort of an energy – emerging energy superpower because of our oil and gas production, right? And that's – and I think that that attitude has sort of certainly pervaded the way in which we think about sanctions that affect the oil markets in particular, but also sort of this intersection on gas as well. So the U.S. is now in a period of time that I think is much shorter than I would have appreciated it being possible, morphed into this position of thinking about its own energy resources as a tool of both economic engagement and economic coercion differently than we have in the past.

Now, I won't say that we never did any of that. That would be sort of a naïve reading of the way in which energy and geopolitics intersect with each other. But I will say there's a cautionary tale here, which is there is a degree to which, as we start to think about – you know, that we have sanctions on, quite frankly, the only thing in common – well, there's probably lots of things in common – but between Russia, and Iran, and Venezuela, they are happy to be large hydrocarbon, you know, resource-rich nations that sell into the global economy, or have over a period of time. As we sort of take them

off the table for future investment, as we sort of think about the fact that right now the measures of our ability to enact sanctions on those countries that affect the energy sectors – whether or not it moves the oil market – that is a lousy proxy for energy security. Oil prices are lousy proxy for energy security. Just like GDP's a lousy proxy for how we're doing as an economy, by the way, but that's a different conference.

So I think we've got to be very careful, because a lot of this is being done in the context of, well, the sanctions are part of a broader foreign policy objective, under which we're taking some action. And once that's done, they'll be gone. Now, in the last Iran round, that was true, right? That was true. But there are cautionary tales there as well, because once they were gone investment was encouraged by the energy sector to go back in, and then that was punished, right? So we have to – and that is not to say that that was – I'm not being normative about that decision. I'm making an observation that we tend to do this. It was not different in the situation with Venezuela. In the situation with Venezuela, we were talking about Venezuela and sanctions. There was this overly exuberant, "The Venezuelan regime is going to fall." And the U.S. energy industry, along with others, are going to go back in and rehabilitate the country. OK. Until when? Until we don't like the behavior again?

So I think we have to really – I was really pleased to hear Undersecretary Mandelker talk about cooperating and collaboration with the private sector, in addition to thinking about alliances as well, because I do think it is a – it is a vastly different oil market. It's a vastly different energy market out there. When we think about how U.S. companies are involved, how U.S. financial institutions are involved, they are not necessarily – they work very hard to try not to be involved with criminal elements. And I think we've got to give a lot of credit to what the Treasury Department is doing in terms of going after corrupt activities and criminal networks. There is an extremely important reason why we need to preserve the utility of these tools, that is for sure.

It's in these other ways that it rubs up against sort of activity that nobody wants to punish the activity in and of itself, but it's seen as being part of a broader foreign policy objective. And this is the place in which, I think, you start to sort of see the longer-term concerns of the energy sector being reflected. And one is ambiguity in sort of sanctions, is that going to be a constant feature, right? We've seen in the past when certain designations or certain sort of rules, particularly in Russia on the unconventionals and things, there's a lot of things that aren't explained, and then subsequently explained. There's a lot of questions in the industry about whether that is something that happens – that is a learning curve process, versus something that's done to make compliance a little bit broader than it might otherwise been if they were specific.

So I actually – you know, watching this from sort of the energy sector perspective, I think that there is a real need to think about not only the way in which specific sanctions affect investments in the energy sector in specific cases, but more broadly as we start to think about some of the things that, you know, Kevin was talking about on the trade front, and we talked about in the other panels as well, how we think about energy as a tool of influence, as a part of U.S. foreign policy, as a part of how we deal with other countries. I think that's the broader evolving trend here, that is about sanctions, but it's about much more than that. And I would say, as we think about – it's not just, hey, can other countries come up with tools to circumvent the sanctions. Are we seeing transactions happen in non-dollar denomination terms? Sure. Are we seeing, you know, people choose strategic partnerships for projects, or build capabilities to get around some of these things? Sure.

It's really, do we want energy to be included in the sort of coercive economic measures realm, and how much? And how much do we want that to happen? And we are doing this from a period of strength right now. Should the U.S. energy production situation change – I would, say, quite frankly, we're still deeply integrated at the global oil market, so we need to be quite humble about that. If all of a sudden our own vulnerabilities were on the table, would we – would we look at this differently? And what are we doing to sort of think about the future of energy security in that light? That's not to say sanctions have no place in this discussion. It's just that that's how I think about that longer strategic thrust.

MS. SEGAL: All right. Well, your comments actually got to what I wanted to ask all of you about next, but maybe – let me start with Peter, but then ask others to weigh in. One kind of theme that came across in what all of you have said – one, the complexity of what's out there, but also the uncertainty. What could be coming next, or how it would be implemented? And I'm wondering, starting with Peter, if you could talk to how private sector actors are responding to that uncertainty. What steps are they taking? How is it that they're able to manage that sort of environment?

MR. FLANAGAN: It's a good question because – and Sarah alluded to this – the energy companies have long-term horizons for their projects. They need to be thinking about contingencies. The supply chain for goods and technology are long and complicated. And in a world of uncertainty, it's difficult to really navigate that trail. And so I think what I see among the clients we work with is a real focus on heightened diligence, on counterparty risk. I would say that the companies are embracing the guidance of OFAC put out earlier this year about the kind of best elements of a well-functioning compliance program. So that's a tremendous investment in trying to understand, digest, and implement the range of controls in this area.

I would say there's also some stepping back from certain projects in areas where the authorities are on the books, but it's uncertain how they might be implemented. We've seen this in Venezuela, as I mentioned, where secondary sanctions are available, but it's unclear how they'll be utilized. Same thing in Russia in terms of possible exposure for significant transactions with, you know, Russian SDNs. That can have a broad impact, if any of those parties are in your supply chain. So I see some companies stepping back from projects that they might have otherwise tried to pursue and to run to ground in terms of absolute certainty on the compliance front.

But it's difficult, because the administration, understandably, needs to preserve flexibility, as I think Undersecretary Mandelker emphasized. But the companies really need to be planning in ways that they can have an ability to get out of projects without risk of penalty or complete projects and recoup payment. I mean, one of the biggest issues that companies have seen as secondary sanctions were ratcheted back up on Iran is how to get paid for projects that might have been undertaken lawfully in that period, as Sarah mentioned, when investment was encouraged, when there was trading. How do you recoup those debts? And that's an important point. So it's a very challenging period.

MS. SEGAL: Right. Kevin, do you – do want to take a shot at that question. And also, I'm thinking back to the piece that you all authored a week or so ago, where you look at sanctions but you also look at a number of the other tools that are actually being used, and how this all kind of feeds into an overall picture of operating in what I think is a challenging global environment. Can you talk a little bit about where sanctions fit?

MR. BOOK: Sure. Yeah, so – to Peter's point, the strategic uncertainties that are created have a lot of tactical application. If you go back a few months, Special Envoy for Venezuela Elliott Abrams

talked about how he'd had conversations with refiners in other countries not to buy Venezuelan crude oil. Now, that sounds a bit odd, because we hadn't officially said we'd imposed secondary sanctions – sanctions barring third parties from purchasing Venezuelan oil. We had, however, made it clear they weren't to use dollars, starting mid-April, late April. And interestingly enough, those threats – those conversations can have the effect of actually implementing the secondary sanctions, without having to put the secondary sanctions in place. Which itself can be useful, because you'll have to untangle a mess if you light up the grid of financial connections between companies that are actually on the side of good that inadvertently became entangled with some of the bad actors that the secretary mentioned.

Now, there are another set of economic force projection tools. I mean, Peter mentioned export controls. And that's really about our technologies that other countries want to access. And if you go back to, like, a previous set of pipeline sanctions, say, from the 1980s on the Yamal pipeline, which got built and currently supplies Europe from Siberia. But we stopped technology – U.S. technology from going on. There's other economic force projection that doesn't have anything to do with sanctions, though – trade authorities. And in some ways, if you think about what tariffs are, you know, they're not exactly the same tool. They're taxes – taxes imposed by the buyer of a product. But in a context of economic strength, economic strength that happens to dovetail with energy strengthen, we're actually quite comfortable with that too. Economic force projection is available across the board. And when the country is doing well, and also when the country is energy secure.

One thing I will say, though, is that those tariffs, to the extent that they have undermined expectations for future growth and demand, have provided a buffer that can – as Sarah said, I might not have been quite as forceful, I still kind of like GDP, I'm a fan – (laughter) – but you know, the indicator of price, even of real-dollar price adjusted in today's dollars, is not a good indicator because there is an insane amount of supply risk out there right now. Nor is price itself convenient for people who really have to transact in this market. Cutting off Venezuelan crude oil did something to a differential between different prices for different grades of crude oil, which was disastrous for refineries that were buying heavy crude oil. Heavy crude oil became very scarce. It's available in other places. Hard to get from Canada right now. We're missing apparently – oh, you've heard this before – a pipeline. But there's still some up there, I'm told.

But in any case, the mechanisms of action – you know, in the context of heavy-duty trade action, it actually makes room for some of – for some of the sanctions actions that might otherwise elevate that bad indicator but the one we all use, price.

MS. SEGAL: Well, yeah. I'll put my vote in the column of GDP, yes, but as an element that we should be evaluating, not the exclusive element. But I think – I mean, you got at the challenges of assessing the impacts of sanctions when you're trying to really isolate that variable, but it's basically impossible, and in particular more challenging when you do have a healthy economy and other sources of energy coming online. It challenges, I think, the goal of the undersecretary of her team, when they go back and iterate and try and assess what are the impacts of the sanctions policy. So it's – you put it more eloquently than I just did, but I think that's a really key point and a key takeaway from the discussion.

Sarah, talking about impacts, maybe focusing a bit on how this is impacting not just investment in energy but some of the other elements of developments in the energy sector, whether it comes to a denomination of contracts – and here, we can connect a bit to the discussion from the last panel, and whether or not some of this activity is pushing against continuing to use the dollar, pushing in the

direction of kind of work-around solutions. Can you maybe talk to some of the other impacts beyond what just be the intended impacts of the sanctions policy in the first place?

MS. LADISLAW: Sure, yeah. And, you know, I want to say, I think that a lot of times when we talk about the unintended consequences, or the impacts of sanctions policy, particularly in my world, on the energy sector, it is not to say there are excuses not to use the tools, right? There are – hopefully there are lessons to be learned about how to use some of them better or how to understand the risks to the tools not actually being effective. So for – I might ask the undersecretary, you know, how much they are tracking the degree to which either folks are using non-dollar denominated assets, trying to create like-capabilities, like what we have here in other places, or trying to, you know, develop capabilities that may have been sanctioned, you know, so just conventional oil development capabilities, or LNG contracting capabilities, or things that they're worried about. They would typically go to a Western-based, you know, contractor, or service company, or someone to carry out those activities, looking to other countries to do.

And the answer is, as patient as we are going to be on our sanctions, they are going to be less patient on developing those alternative capabilities. And we've seen a significant uptick. Now, that being said, it's – I think that the argument that a lot of people make when they're evaluating this question of, is there – is there a near-term threat to the, you know, dollar dominance in the global monetary system? Not necessarily, no. But we are giving people lots of reason within the energy space to evaluate how close they can be to Western financial capabilities, to Western technological companies, to Western capabilities.

Because to say, which I hear people say all the time, they say, well, it's the fault – and this is the oil and gas, you know, community because that's kind of what we're talking about – it's the fault of the oil and gas community for going to places where, you know, they have dodgy behavior, or we have foreign policy conflicts. And it's, like, well, they didn't exactly pick where the oil and gas was going to be. And that is sort of the nature of the industry. Now, associating with corrupt practices and corrupt regimes is an entirely different ball of wax. So I think those are differentiated.

The thing I want to – I think that there – we're coming up upon what I hope will be an inflection point in our understanding of how sanctions are affecting a whole bunch of different things, but the energy sector in particular, for a couple of reasons. One, I look at some of the ways in which we are thinking creatively about additional things to sanction. And the recognition by people that, you know what, they're probably not going to solve the foreign policy objective at hand. They are probably designed to punish. They're probably designed to cause some sort of difficulty with some – and we can talk about the sort of Nord Stream 2 thing in particular.

So what happens if we sanction Nord Stream 2, and the pipeline happens anyway? What happens if we increasingly sanction a variety of different, you know, projects, or activities, or sectors, and people find workarounds, right? What does that do to this very powerful tool that we're talking about that's supposed to be helping us achieve some sort of objective? It's not fundamentally different than a lot of military assets that we think about. We get a lot of power projection and stability and a whole bunch of different things out of the defense apparatus that we have. We get the same kind of benefits from the sort of financial system that we have and from the energy prowess that we have.

The degree to which we make people try to find alternatives from that, or the degree to which we show that things that we try to achieve with those ends we're ineffective at achieving will be doing sort of longer-term harm. So I know that second part wasn't what you asked, but.

MS. SEGAL: No, but it does get to kind of the potency of the tool, and as you sort of increase the usage of that tool, does it maintain its potency, which is kind of the overall objective in the first place. So I think it's – I think it's a good point. And it's related to the last question I'm going to pose to all of you, and then turn it over to the audience for their questions. But it was something that was raised both in the keynote and then in the first panel. But it's the coordination, the quality, and sufficiency of coordination with partner countries, but also I would say with the private sector, and the communication with the private sector to convey the goals of policy and the aims of that policy, and whether from where you all sit how you would assess, I guess, the quality and sufficiency of that engagement. Whether we're talking kind of on the official sector side or with the private sector. Any of you like to take that?

MR. BOOK: Peter is making the appropriate dodge given that – (inaudible) – is leaving and dealing with those stories. (Laughter.) I'm really an analyst, so I'll jump all over that.

Look, the problem is one of execution and the necessity for secrecy when conducting military, or the economic equivalent of military, operations. You don't say I'm going to attack at this time, at this place, and you should know that, unless you're trying to help your adversary evade the attack. So the secrecy unfortunately wraps up a whole bunch of companies into a mess. They're left with uncertainty. And the best decision in response to uncertainty is not risk. Then, even when they have clarity, they have a lack of clarity into the decision process underlying the mechanism, as Sarah mentioned. Things can change. You thought you were good, and you're not.

The communication then is it's difficult to have an interface with the commercial side of the energy sector here in the U.S. and to say, "Here is what we're going to do and when." I think they do a pretty good job of explaining things after the fact and telegraphing that things are coming. So, there's defined dates very often that explain when things are going to happen. Some are mandated by statute. Some are interpreted by regulation. But they say, "Well, here's what we're going to do when." Some are explicitly political decisions, like the withdrawal from the Joint Comprehensive Plan of Action and the subsequent six-month wind down, right, which was structured using statutory authority but subject to the choice – the political choice of the administration.

So you have a sense of what's coming most of the time. There's more recent examples that are, you know, somewhat more surprising. I think one of them was General License 8, associated with the Venezuela petroleum sanctions, which I know all of you must know by heart, which allowed five companies to continue operating in Venezuela. And that license was due to expire in, I guess it was – it was over the weekend, on the 27th. And it was extended for three months on the 26th. There was a lot of uncertainty about whether it would have been. And, again, this is a necessary part of executing economic statecraft. I'm not sure you could do much better than that. But it creates investment challenges for the companies involved, for sure.

MR. FLANAGAN: Yeah, I agree with Kevin on – across the board. I think the administration is trying to approach these problems with a more nuanced set of tools. And that is commendable. It's challenging. But it also makes the dialogue – the process of dialogue with industry more complicated, because you – as you kind of focus the tool, you have to think about what the intended impact is. They may not fully appreciate the consequences of some of the measures. The last panel mentioned the impact of – on aluminum markets when RUSAL was subject to comprehensive sanctions. It was heavily involved in aspects of that. And I think the Treasury Department, through General License, tried to signal to give relief to industry on how it could operate, and to try to work with industry to get

to a place where the ownership of RUSAL could be restructured, which was a real policy aim, but not to do damage to international markets.

That's a good case study of both the unintended consequences of sanctions sometimes, the importance of staying engaged with industry through informal means but through the formal General Licenses that Kevin was describing, and also trying to be transparent about what you're trying to accomplish, because I think industry, if it's clear what the objective is – whether it's we don't want trade in Venezuelan crude or we don't want the transfer of U.S. technology in support of unconventional projects in Russia – if the target is clear, industry can respond. It's when the target is unclear that it – there's breakdowns. And breakdowns operationally because of the complexity of these businesses and the projects, and the challenges of responding to policies that lack a focus.

MS. SEGAL: Right. Yeah, I feel like this is a recurring theme that's coming back a lot, and actually some of the questions from the audience already. Sarah, do you want to weigh in on this question, or are you?

MS. LADISLAW: Yeah, I mean, I guess the only thing I would say real quick is, you know, to be quite specific, I think that one of the things I wonder about is I don't see – and we had Brian Hook here not too long ago talking about this. I don't think it's going to work. So what? So what are we going to do? You know, and now we've got sort of this situation in the Gulf where oil prices aren't moving, but we basically said, "Hey, you know, maybe we shouldn't be protecting, you know, the Strait of Hormuz on our own." Which is not a fundamentally – my colleagues have written about this – it's not a fundamentally different position than we were evolving to in a much sort of simpler, smoother, sort of diplomatic process – which is maybe we should have a shared cooperation for who's going to do this.

But I think we've just sort of found ourselves in this position where our maximum economic pressure strategy isn't going to yield a desired outcome. The Iranians have effectively shown that they have this very different, in asymmetric terms, sort of different reach around the world outside of what we're targeting. What are we going to do? Like, what comes next? So maybe Iran stays off the oil market for a while. That's probably something, you know, that's a plausible outcome. Venezuela, that could be a plausible outcome. I still don't know how the resolution in Venezuela's going to come about. This idea that patience will yield outcomes – I think patience could also just yield stalemates. And that's OK.

Russia, that's different. They have a million barrels a day on the market. That's a different ball of wax. We're going to play with them differently. And so I think – anyway, I just think that the lack of resolution on those things is going to – is one of the complicating factors.

MS. SEGAL: Yeah. Well, that's another kind of takeaway for me from this morning's discussion, is just how – you can't talk about this monolithically. These are really very different depending on the country and the sectors that we're talking about.

OK. Enough. From me for now. We've got 15 minutes, plus or minus, for some questions. So if you have a question, if you could raise your hand. The mic will come to you. If you can just identify yourself and your affiliation, we will go from there. So there's a question right here, a woman in the back.

Q: Thank you. I'm Sabrina Hasek (ph). I'm with the Liberal Arts and Science Academy. I'm actually a high school student.

And I'm wondering, how do we limit and isolate unintended consequences on the private sector while still reducing malign activities? Thank you.

MR. FLANAGAN: Well, I'm happy to take a crack at that too. It's a very good question. As I alluded to in the last round of questions, the unintended consequences are, I think, greatest when the policy aim of the sanction is less clear. And so I think the – for my – well, from where I sit in working with companies to navigate these kinds of restrictions, it's when the aims of the sanctions, the precise prohibitions are clearest, and when the administration is prepared to be nimble in responding to market disruption. As we saw with the RUSAL sanctions, there were unintended consequences on totally innocent companies that just happened to have supply relationships, joint ventures, reliance on counterparties that had derivative risk.

And so I think the administration needs to be nimble in exercising some of the licensing authority that that the undersecretary alluded to, to provide prompt guidance about what the scope of the prohibitions are, and where there is relief for companies that are trying to comply with the ultimate objective, and the kind of wind-down relief that Kevin alluded to. Which is not a create of statute or executive order. That's administrative. That's something that the administration allows as a discretionary matter. So allowing some wind down to help companies transition to what the new expectations are I think is another way to limit unintended consequences.

MR. BOOK: If I could just add one thing. There's times when time will assist in that. So you want to buffer industry against unintended consequences, here's a heads-up. You've got six months. Well, there's some things you can unwind in six months. There's some things you can't unwind, right? If you think about the assets that are put into the ground in other people's countries, U.S. companies in particular – but even U.S. allies' domiciled companies – have limited ability to just withdraw. They have to write down. Essentially there is a loss.

So at some level there's a willingness to shoot the hostage that comes with this. And that isn't an appealing part of the tool, but it raises the question about why are you doing it? And with clear purpose, a lot of companies operating in the U.S. and in U.S.-allied countries are usually OK with that, because they think about the long game. They think about the long game of working with stable democracies with transparent rule of law and they say, all right, that's fine. But, look, time doesn't solve all things. Sometimes if it's most of your business in a given operating environment, and you can't operate in that environment, that's simply bad news.

MS. LADISLAW: If I could just add one small thing to that, because we didn't talk about it very much. I think – it depends on what you mean by unintended consequences. But the communication between the executive branch and Congress is extremely important, right? There's a certain level of professionalization and watching for these kinds of mechanisms that goes on with the executive branch. I think with CAATSA and some other things, there's been the concern that maybe, you know, we don't usually accuse Congress of being able to pull things off quickly, but in the realm of sanctions they have shown themselves able to do things quickly. There's a lot of work going into ensuring that Congress thinks about those types of unintended consequences as deliberately as we've come to expect from the folks from Treasury. That will continue to need attention.

I will say, and this is not a plug for think tanks, I don't care who does it, but there's a lot more academic study of this area that needs to be done. We're dealing with it very transactionally. It's very real-time. It's very cutting-edge. There's very few people sort of thinking about what makes these tools effective and what helps answer the question you said. So you're in high school. Go to college. Do this. (Laughter.)

MS. SEGAL: OK. Another question. Here in the front row.

Q: Thank you. I'm Robert Thomason I'm a reporter for MLex, a business publication.

And basically my question is trying to take the abstract concept of rule of law and apply it to the practicalities of sanctions. When policymakers talk about their proposals they say, "We have good rule of law here in the United States." And people don't want to be divorced from that. If you're sanctioned, you know, or if you're considering being sanctioned, or taking an action that's sanctionable, do you want – do you want your money in a supervised U.S. bank, or do you want it in some new crypto-exchange? Do you want your contract to be here in the United States, where you have courts that are enforceable, or do you want to take your chances with Russia or China? If that's the workaround. So basically, my question is, as practitioners, are you seeing this as a motivation among your clients and the people you deal with, that they really want to be close to the U.S. system and the rule of law? Or are these policymakers just making aspirational statements about effect?

MR. FLANAGAN: I mean, are you asking, is it driving people away from the U.S. market? Is that –

Q: No, are the U.S. markets – you know, are the U.S. markets really the incentive on – I think Ms. Conley talked about carrots. You know, it kind of relates to your concept of the workarounds and the immunization. Are you finding people so desirous of being in the United States and having such protections as we provide, or are they saying, hey, we're going to – we see workarounds?

MS. FLANAGAN: Well, I think Jon in the last panel was commenting on the fact that these sanctions work because the U.S. system has a reach and a scope where it can extend far beyond our borders. And, as you say, companies rely upon the transparency and the rule of law in the United States for their contracting. They rely upon U.S. suppliers, given the quality of the technology. They rely upon the financial system because of the importance of the dollar and the – and the strength of our banks.

I don't see – I mean, I think some of the sanctions are driving companies to think about contingencies, but I don't see a fundamental shift away, necessarily, from the importance of the U.S. system in the energy sector. I think the U.S. companies, the U.S. technology, the U.S. banking system is still important. But I think there is a growing recognition that there's a – there's a vulnerability. That is a point of vulnerability when companies are connected to the U.S. system. It's not unlike the realization that China is coming upon with respect to Huawei or some of the other Chinese companies that are cut off from U.S. technology. There are consequences to being reliant and integrated with U.S. suppliers. But I still think the importance of the economy is central.

I don't know if Kevin or – you may have a different perspective on it.

MR. BOOK: No, no. The dollar's really important too.

MR. FLANAGAN: Yeah.

MR. BOOK: So your workarounds involve bearing currency risk. You know, in the most benign sense, using a currency that's more volatile than the dollar, or one that you may be stuck in longer without the ability to have the liquidity of the dollar. But in its more evolved, you have the question of whether the guys with the flash drive who runs the exchange gets lost and never comes back. And then all your money's locked up in digital nowhere. You can't run a business that way, right? You hedge currencies to manage currency risk. But if you incur greater hedging costs, this is a disadvantage.

And in terms of what energy investment involves, you know, a lot of the projects and the operations we're talking about, an individual transaction by itself is a contract, right? It's a contract to charter a ship or to buy a certain volume of a commodity. So you want to have a place where you can contract carefully, right? That's everything. But when you're actually putting money in the ground somewhere else you need to have a really strong government behind you when it's time to deal with disputes with the government – particularly in an era where we're losing the investor-state dispute settlement tool from energies companies' toolkits increasingly. So, I think, you know, having the U.S. as a nexus is extremely important and very attractive. And doing this kind of business, in the multiple billions of dollars, another way is just very risky.

MS. SEGAL: Yeah. I think Heather Conley on the last panel kind of got at a variation of your question in talking about how has Russia, for instance, now done a calculation that this is not – the sanction is not necessarily to incentivize a particular outcome, so much as just a new operating reality for them? And if that would then incentivize kind of a long-term workaround, just very different way of doing business? And it probably is most salient when you're talking about financial sanctions and kind of dollar centrality. I think energy might be a little bit different of an animal. But I think that's kind of the uber question overriding, you know, whether the extensive use of sanctions will ultimately result in some sort of change in behavior that means that sanctions are just not going to be as effective as in the past. But it's a fundamental question, I think.

Others from the audience? There's one here in the second to last row.

Q: Hello. My name is Adam. I'm with the International Crisis Group.

I had a question about these sanctions that are targeting Venezuela, Iran, Russia, all – that you had mentioned – all major oil producers. These sanctions will be in effect, seemingly, for the years to come. I was wondering what that effect will have – or, what the effect will be on renewables energies, especially for Europe as they look to their energy future, you know, along with the climate crisis – how that changes their calculation on what they should be investing in?

MR. BOOK: Yeah, I mean, so there's a lot of ways to answer that. I think, Sarah, between the two of us, we could come up with a hundred and keep you here for the next four hours. (Laughter.) I'll keep my stab at it very short. There are still barrels getting combusted in the world. Substitute barrels can find a market today. There wasn't always a substitute available, and there won't always be substitutes, necessarily, available. But right now, there's certainly no carbon benefit from sanctions, if you want to think of it that way. Cutting off a specific barrel hasn't changed very much. And if it does, it's very much at the margin. So, the differential impact of a slightly different crude combusted makes very little difference in the vast stock of carbon in the atmosphere.

In terms of what happens to renewables and other types of energy: so, the laws underpinning some of the sanctions are written specifically to target petroleum. But other sanctions, which are about investment in general, are not. And in addition, the licensing of technologies. You bring up, you know, sort of the non-sanctions area. And Peter's – you know, Peter's mentioned sort of the security side of commerce. Well, things like Huawei making inverters, for example, for solar panels, that's a – they're a big supplier of inverters. The idea that we'd have security controls on a basic tool for the installation of renewable energy could have a very big impact.

The other deal is that there's a lot of capital in some of the sanctioned countries. Some of them are in sunny places that have energy evolutions yet to come. And leapfrogging into renewables makes sense for them. Cutting them off means that there's a lack of an opportunity for that technology to get deployed. And that too could be a problem. But I don't want to hog the spotlight. You've got a lot of thoughts on this one too.

MS. LADISLAW: (Laughs.) I'll just add two very quickly. One, you know, it was a weird sort of byproduct of the first Iranian sanctions – you know, run-up to JCPOA. We got a lot of queries about whether this was, like, sort of Iran's renewable energy moment, which I found really interesting because it was like, well, it's still hard to do lots of different kinds of investing in Iran. But there was this view that – you know, that there some sort of renewable energy opportunity. And it wasn't a one-off. There was actually a considerable amount of thought put into it.

The other thing I will say is, with regard to your question about Europe and some of the perspective there, this is where I think that, you know, one, we should – we have two problems as we talk about sanctions. One, we sort of talk about them broadly, and there's a lot of different ones, they do a lot of different things. We also talk about sanctions as sort of a proxy for coercive economic statecraft. Coercive economic statecraft is something that I think we're going to increasingly run into problems with Europe on, because as long as we're doing things together, then I think we'll have a lot of ground that we can continue to cooperate on. When this sort of becomes a U.S. unilateral, "as long as it doesn't hurt us, if it hurts you not so bad" sort of dynamic, I expect over time countries will respond to that.

And so one of Kevin's sort of favorite things to talk about in that realm is, you know, along the trade side of this equation, the extent to which, you know, European countries, or the European Union as a whole, decide to trade with, you know, carbon compliant likeminded countries, to the extent that we start to extend sort of carbon and low-carbon technologies into our trade discussions as a coercive measure as well. This is – again, not – I wouldn't necessarily be against some of those things, but I think that this is – we're getting into this territory where thinking about using our – both our trade and our sanctions tools to affect other countries' domestic behavior is more and more going to be part of a vision that we see as part of the geopolitics of energy.

MS. SEGAL: OK. I think we have time for one more question, if there's one. There's one here in the back.

Q: I'm Grace Kang of the Institute for Korean-American Studies.

Sanctions have been credited with bringing North Korea to the table. I would like to hear your assessment of the sanctions against North Korea now, given the importance of coal for North Korea, and the importance of China, and the fact that we are having a trade war with them right now.

MR. BOOK: So, yeah. I mean, part of – part of the – so in terms of North Korea, coal's extremely important. From sort of at the margin, China's a 4 billion ton a year consumer of coal. And so North Korea's contribution, or the lack thereof, is less relevant. So as a coercive tool, you know, the impact – where China's energy consumption and trade war impacts have been more heavily felt has been in cases where, for example, for the want of coal – they've been short of natural gas because they've been trying to transition away. That would give us theoretical leverage as a supplier of natural gas on the water, and yet they've put tariffs on our natural gas as part of trade war. Trade war is about bigger things than energy. And this comes up over and over again. And national security is about bigger things than energy.

Now, from the other side of the equation, if you're a small producer nation, and you're not a widely diversified economy like the U.S. with global market access like we have, and the opportunity to reroute cargos of crude and LNG somewhere else – if you're North Korea, this is an extremely important issue. And so, I mean, the – we wouldn't want to generalize. There's a case where you can make the case that there's a real impact on cash flows as a percentage of total government operations. And it's going to be meaningful. The consuming nation, though, in this particular case, China, as a destination market has a lot of flexibility, and it's fighting a bigger fight on a longer time scale.

MR. FLANAGAN: This is also an area where the administration has put in place, through executive order and also pursuant to U.N. resolution, a pretty robust set of secondary sanctions tools that it could utilize and does utilize episodically. But I would say that the – it seems that the administration stepped back from the earlier plan to really push particularly China with respect to trade with North Korea. Whether it's North Korean workers or cross-border trade, the tools are there. It's another area where China's probably assessing, well, what is the resolve? How much will these tools be utilized, because there it's an area where you really could exert some pressure through secondary sanctions.

MS. SEGAL: Mmm hmm. Well, I guess an appropriate final question, because it's another example – as in all the ones we've talked about today – where we're really not at the end point. So we're kind of midstream assessing where we are, and what the outcome's going to be. So I guess that's a reason for a future event. (Laughs.) But for now, please join me in thanking our panelists, and we're going to reception. (Applause.)

(END)