



Economic Sanctions

Law and Public Policy

Kern Alexander



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Preface

Economic sanctions have attracted a great deal of attention in recent years because of their increased use and the substantial economic and social costs they impose on targeted countries, businesses and individuals. They also create considerable opportunity costs for firms and investors in the countries of the sanctioning states and major implementation challenges for both developed and developing countries. Before 1990, the United Nations Security Council had adopted mandatory economic sanctions only on two occasions: against Southern Rhodesia from 1966–1977 in the form of a comprehensive embargo on trade and investment, and a more limited arms embargo against South Africa from 1977–1990. Since 1990, the Security Council has greatly increased its use of mandatory sanctions by adopting at least 17 different economic sanctions programmes against states and alleged terrorists and terrorist organisations. The most significant Security Council sanctions programmes in the 1990s were broad-based economic embargoes against countries such as Iraq, Yugoslavia, and Haiti. Although these sanctions generally achieved their stated objectives, they imposed immense humanitarian costs on the civilian populations of those countries. To address these concerns, Security Council sanctions became more targeted and precise in their application, often directed against the political and business elites of a targeted state, rather than against the whole population or economy of a state. Moreover, the traditional application of sanctions against states and their nationals began to evolve in the 1990s to include individuals, business entities, and other organisations regardless of their nationalities or geographic location. Indeed, the so-called war on terrorism has resulted in many states dramatically expanding the application of economic sanctions to non-state actors who are allegedly involved in terrorism, drug trafficking, and economic crime. This has raised a number of important issues regarding the scope and intensity of sanctions and whether they are achieving their public policy objectives, and whether legal safeguards are adequate to protect individuals and businesses from unjustified application.

The book examines the national economic sanctions programmes of some leading states and the European Union and attempts to draw some lessons regarding how to apply sanctions more effectively in today's globalised economy. An important focus will be on the legal and regulatory framework for implementing sanctions and some of the economic issues involved in their application. Particular attention will be paid to the European Union and the United States. The European Union has adopted a Common Policy on economic sanctions and a set of principles for their application. The EU Council has enacted a number of regulations designating states, firms, and individuals who have been targeted by the Security Council or have been targeted by EU

policyholders independently of the Security Council. EU unilateral sanctions have been applied against states such as Belarus, Burma, Uzbekistan, and Zimbabwe, mainly for human rights violations and failure to adopt democratic reforms. The United States has a long tradition of using unilateral and extra-territorial sanctions as an important component of its foreign policy. Extra-territorial US sanctions pose a serious compliance risk to businesses operating in third countries that are not the direct target of US sanctions. Although some bilateral arrangements between the EU and US have softened the extra-territorial edge of US sanctions, more work needs to be done at the multilateral level to ensure that other third country states do not suffer unnecessary collateral damage because of unilateral US sanctions or other sanctions regimes.

The academic and policymaking literature in recent years has focused mainly on the effectiveness of economic sanctions in achieving stated public policy objectives, their potential infringement of human rights, and the role of the UN Security Council in enhancing their effectiveness. In contrast, this book focuses primarily on the implementation of economic sanctions at the national level and addresses some of the important economic, legal, and regulatory issues regarding their design and implementation. An important focus will be on the legal principles and doctrines that affect compliance for companies, firms, third party advisers, and investors. The overriding argument is that economic sanctions can be an effective instrument of public policy if they are designed to take account of the state's economic capacity to implement them and if the legal and regulatory techniques utilised are proportional and targeted in their application. Further, it suggests some modest points for international institutional reform that rely primarily on a robust domestic legal and regulatory framework. Although multilateral institutions and the UN sanctions committees have an important role to play in guiding states to adopt more efficacious sanctions measures, the real focus of public policy must be on the economic incentives that individual states have in adopting sanctions and how legal and regulatory approaches can be devised at the national level to achieve the state's objectives.

This study arose out of research that was conducted at the UK Economic and Social Research Council's Centre for Business Research, University of Cambridge, and at the Institute of Advanced Legal Studies, University of London. The early stage of the research examined the impact of financial sanctions on the commercial activities of multi-national enterprises with particular focus on the application of extra-territorial US sanctions. Later, the research focused on the implementation of financial sanctions in the national regulatory regimes of some EU states, Japan, Russia, and the United States. In recent years, the research has continued as part of a research project on global financial governance at the Centre for Financial Analysis and Policy, University of Cambridge. At the Centre, I received valuable administrative assistance and research support. A number of international organisations allowed me to have access to economic data and to interview officials involved in the sanctions debate. In particular, the Bank for

International Settlements provided data on the use of currencies by banks in multiple jurisdictions and the extent of bank exposures in the reserve currencies. The World Bank provided useful data on gross domestic product growth rates across countries over time and on governance reform in domestic economies. The United Nations Conference on Trade and Development provided a venue for me to present some of the results of the research and to discuss with policymakers the impact of economic sanctions in developing countries and its effect on economic and financial development.

A number of academics, policymakers, and business practitioners provided useful insights into the economic, legal, and regulatory issues raised by economic sanctions. I am particularly grateful to Professor Johan Henning of the University of the Orange Free State in South Africa for sharing with me his unsurpassed knowledge of corporate law principles of control liability under Roman-Dutch and English law and the impact of economic sanctions on South Africa during the apartheid era. Special thanks to Professor Mads Andenas for his very helpful comments on the interaction of international, EU, and member state law in the context of economic sanctions regulation. Space limitations preclude me from listing all those who provided useful insights and inspiration but I would like to thank specifically Fletcher Baldwin, John Eatwell, Peter Fitzgerald, Mette Jamasb, Donna Harris, Christine Kaufmann, Teruo Komori, Andreas Heinemann, Deepali Fernandes, Marcus Miller, Elisabeth Tuerk, James Bacchus, Tugrul Vehbi, and Sachiko Yoshimura for their valuable assistance, comments, and support. I would also like to thank Dr Eric Herring and Paul Bentall for their role in facilitating my discussions with UK policymakers. I benefited immensely from several interviews with UK and US government officials and from the observations of academics, policymakers, and practitioners whom I met at conferences organised by the American Bar Association, International Law Association, International Monetary Fund, the European Commission, and the European Union Parliament Committee on Economic and Monetary Affairs. In the latter stages of the work, the Chairman of the House of Lords Select Committee on Economic Affairs, Lord Wakeham, provided me with a dynamic venue to present my analysis of the UK and EU sanctions regime before the Select Committee and to be subject to vigorous but fair questions by Committee Peers on the merits of UK policy towards the use of economic sanctions. The Select Committee's staff and specialist adviser were also very helpful.

The book would not have been possible without the advice, patience and careful editorial attention of the publisher Palgrave Macmillan and its production team to whom I am very grateful. Special thanks also to my family and in particular to my wife Natalia for their unstinting support throughout. Any errors are my sole responsibility.

Kern Alexander
August 2008
Zurich

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Introduction

Economic sanctions are important instruments of public policy which have attracted much controversy in recent years because of their growing use and the significant economic and social costs they impose on target states, non-state actors and third parties. They have become integral features of many states' regulatory systems and can take the form of trade embargoes, export controls, and restrictions on financing, investment and state aid. The experience of the United Nations sanctions programme against Iraq in the 1990s, however, demonstrated that broad-based economic sanctions can impose severe social costs on civilian populations while not necessarily achieving their objectives. Consequently, the sanctions programmes of the UN Security Council and many states have evolved to rely more on targeted sanctions (so-called 'smart sanctions') that consist of export controls on strategic goods and services, travel restrictions for designated individuals, and financial asset blocking orders. Since 11th September, 2001, the leading G10 developed countries, led by the United States, are increasingly using targeted economic sanctions against certain states, international terrorist organisations, and drug traffickers.

Economic sanctions can also be imposed against third party companies, firms and other organizations that provide direct or indirect services or support to the primary target of the sanctions. Indeed, sanctions often create civil and/or criminal liability under national laws for third party businesses that conduct or facilitate transactions with targeted states, terrorist organisations, and individuals. The growing impact of economic sanctions on the operations of companies and firms has made compliance with international and national sanctions requirements an important aspect of corporate governance, strategy, and firm reputation. Economic sanctions have also raised human rights concerns regarding their detrimental impact on living conditions. In many cases, targeted sanctions have been imposed on individuals and organizations without prior notice and opportunity for a hearing, thus raising issues of due process and fairness.

Much of the debate in the economic sanctions literature has focused on their lack of effectiveness in achieving stated objectives and the role of the UN Security Council in ensuring their efficacy and adherence to human rights norms (House of Lords, 2007). While recognising these concerns, this book takes a different approach by examining the domestic legal and regulatory framework of economic sanctions and how they can be applied more effectively against corporations and third parties to achieve public policy objectives. In doing so, it analyses the sanctions regimes of some major states with active economic sanctions programmes, including the United States, the United Kingdom, and Japan. Only by understanding how economic sanctions are applied in practice can we develop meaningful theories for devising effective sanctions regimes and for building more robust bilateral and multilateral institutions to administer their cross-border application.

The European Union's sanctions regime provides a useful model for showing how states can use regional institutions to coordinate the application of economic sanctions based on a set of common principles whilst respecting common legal values. Since the first Iraq war in the early 1990s, a complex and vast multilateral sanctions regime has emerged that is coordinated by four sanctions committees of the UN Security Council. In the aftermath of 11th September 2001, under the influence of the Security Council and the Financial Action Task Force, state economic sanctions practice has undergone a dramatic change in which the scope and application of economic and financial sanctions has been extended to include not only targeted states, but also a wide variety of non-state actors that include business entities, political organizations, charities and thousands of individuals who are deemed to be supporting terrorism, economic crime or infringing human rights. While there are many similarities in state sanctions practice, there are distinct differences in regulatory approach and legal technique which creates significant difficulties and complexities for applying sanctions on a cross-border basis. For instance, generally US sanctions have been adopted primarily on a unilateral and extra-territorial basis, while EU and UK sanctions are ordinarily adopted on a territorial basis after consultation and agreement at the EU ministerial level and as part of Security Council sanctions programmes. These divergent approaches have created complex regulatory and legal issues between the EU and US regarding their application to corporations and other business entities, third party professionals, and designated entities and individuals.

In a globalised economy, divergent national regulatory and legal approaches can undermine the effectiveness of sanctions regimes and inhibit efforts at cross-border coordination and cooperation in implementation and enforcement. Although this study suggests that more uniformity is necessary in the legal doctrine and regulatory practices that apply to sanctions practice, it also argues that states should utilise more diverse sanctions instruments

that best fit their own economic capacities and comparative advantage. This would enhance the effectiveness of national and multilateral sanctions programmes and achieve a more equitable burden sharing of the costs for sanctioning states.

I Outline of chapters

Chapter 1 sets forth the origins of modern economic sanctions and their rationale in public policy. It does so by examining the history and origins of the major economic and financial sanctions regimes. In the nineteenth century, economic sanctions were used primarily as part of a broader military strategy during times of war. This changed following the first World War, as some countries under the auspices of the League of Nations began to impose economic and financial sanctions and export controls in lieu of taking military action against countries deemed to be in violation of international obligations. Later, in 1940 – nearly two years before it entered the war – the US began adopting a wide range of economic and financial sanctions against Japan, Nazi Germany and its supporters. Later, during World War II, Great Britain, the US and other belligerent nations began implementing comprehensive export controls and extra-territorial financial controls that were targeted against enemy states, their nationals, and so-called specially-designated entities in third countries (Domke, 1943). Although most countries lifted their economic sanctions following the war, the US maintained and extended most of its export controls and economic sanctions regulations against communist states and other targeted states during the Cold War period. In the 1980s and 1990s, the European Communities and its member states began to adopt a wider range of economic and financial sanctions against states and persons targeted by the EC and the United Nations. In the 1990s, some states led by the US began to expand the focus of their economic sanctions programmes to include not only foreign governments and regimes, but also non-state actors, such as international terrorists and drug traffickers. The growing use of economic sanctions has been enormous and has attracted considerable attention in academic, business and policy circles.

Chapter 2 will review the main theories of international trade and finance that drive the global trading system. It suggests that the theory of comparative advantage can inform policymakers regarding how to design their economic sanctions programmes. Comparative advantage theory provides important insights regarding how states can apply export sanctions more effectively in today's globalised economy. The chapter also analyses data from the Bank for International Settlements and the World Bank to show the growing linkages between the world's major economies and financial markets. The data also show that the US and the G10 industrial states are hegemonic actors in today's globalised financial markets and therefore have the capacity to coordinate the application of financial sanctions on a regional and

potentially global basis. Developing countries should be given assistance in implementing sanctions requirements and should be exempt from international sanctions requirements in circumstances where the application of the sanctions would impose a disproportionate cost on their economy.

Chapter 3 analyses the international legal dimension of economic sanctions by examining the main principles of international law that govern the use of economic sanctions by nation states. It begins by discussing the principles of state responsibility applicable to a state's use of economic sanctions and the relevant principles of jurisdiction and how extra-territorial jurisdiction has grown as an important element in state practice. Chapter 4 examines the state practice of some of the world's major states in their economic sanctions policy. The legal and regulatory practice of the United States, United Kingdom, European Union and Japan will be discussed to show the significant differences between countries in the design of their sanctions regulations and public policy objectives, and in particular the differences in their legal and regulatory principles and doctrines that support their sanctions programmes.

Chapters 5 and 6 analyse the legal and regulatory principles of economic sanctions with particular focus on the US sanctions regime and how it applies to corporations and third party professionals and businesses. The US legal and regulatory framework attracts the most attention because no state has a more comprehensive economic sanctions regime as the US and the principles that underpin it are also applicable to the sanctions programmes of other states. These chapters will compare the US legal doctrines of control liability and third party liability and compare them to the approaches of other leading states. The chapters suggest that more cross-border coordination is needed in the application of legal doctrines and techniques to multinational corporations and other business entities.

Chapter 7 examines the use of private rights of action for civil damages as an instrument of economic sanctions policy. Although most states do not afford private parties civil remedies to recover damages for breach of international legal obligations or more fundamental *jus cogens* norms of international law, the US provides a variety of statutory remedies for private plaintiffs to pursue civil actions in US court to recover compensation and damages against foreign persons and in some cases foreign states for breach of international law. This chapter examines the procedural framework of these remedies and how they extend extra-territorial jurisdiction to third country businesses and individuals who have little or no connection whatsoever with the US but who undertake proscribed transactions or investments involving Cuba, Iran or other US-targeted entities. Also examined will be US court decisions upholding private rights of action against foreign states that support terrorism and the related issues of sovereign immunity. Moreover, private remedies against foreign private parties

(i.e., banks and companies) that have facilitated terrorist activities will be discussed along with the related issues of civil liability and damages.

Chapter 8 analyses the statutory and regulatory responses of some major third country states in their efforts to block the legal effect of extra-territorial US economic sanctions. Although these laws in theory create a direct conflict between third country businesses and the dictates of US sanctions laws, most blocking laws have had little practical impact in deterring the extra-territorial application of US sanctions because they have not been implemented and enforced effectively at the national level. Recent US enforcement actions involving UK and Canadian companies will be discussed.

Chapter 9 examines the bilateral arrangements that have emerged among the major states for co-operation and co-ordination in cross-border sanctions implementation and enforcement. It does this by tracing the recent history of bilateral mutual assistance between the US and its key trading partners to show that the challenges of extra-territoriality and sanctions enforcement and surveillance have been overcome to a limited extent but that regulatory and legal problems remain. The EU-US 1998 Memoranda of Understanding is suggested to provide a model framework of bilateral co-operation in this regard. The chapter suggests, however, that the impetus for the MOU arose from the aggressive enforcement of extra-territorial sanctions by the US which acted as a catalyst to persuade the EU to negotiate an agreement which recognized many of the concerns that the US had with certain targeted states. Nevertheless, the main theme in the chapter is that the use of extra-territorial sanctions can only be effective if undertaken by states acting within a multilateral framework that recognises the legitimacy of international legal institutions and general principles of sovereignty and territorial integrity of states. The use of extra-territorial economic sanctions therefore must be durably linked within a multilateral framework that envisions eventual coordination and co-operation with other states which have similar policy objectives.

Chapter 10 addresses the legal and regulatory risks faced by foreign banks, companies and their professional advisers for involvement in transactions that may violate US financial sanctions and anti-money-laundering controls. The Patriot Act, which enhances US financial sanctions against foreign jurisdictions, foreign institutions, and foreign transactions and accounts of special money-laundering concern, will be examined. Moreover, the Patriot Act has resulted in a comprehensive regulatory regime designed to target not only US financial institutions, but also foreign financial firms, other commercial entities and their advisers who do business with targeted individuals and firms. It also extends the jurisdictional reach of US financial reporting requirements to designated foreign institutions and states, and to accounts and transactions involving US dollar assets. In this respect, the book sheds new light on recent regulatory and legal developments in US practice and its impact on foreign countries. However, although the US has

been a major player in multilateral bodies and international organisations in supporting anti-money laundering and terrorist financing measures, its regulatory practices and enforcement measures often depart from international standards and the findings and decisions of various international committees and multilateral bodies. It will draw on the case of North Korea to show that the unilateral and extra-territorial approach of the US does not necessarily work unless it is accompanied by multilateral coordination with other countries who are instrumental in ensuring that sanctions are applied effectively and achieve their objectives.

Chapter 11 extends the discussion to multilateral institution building with particular focus on post-9/11 developments at the UN Security Council where significant progress has been made in building multilateral institutional structures to adopt and implement an international financial sanctions regime against international terrorism. The main focus will be on the UN Security Council international sanctions that apply to UN-targeted states and the Council's anti-terrorist financing resolutions and the work of the committees that oversee implementation. Also discussed will be the recommendations and model codes of other multilateral bodies, such as the Financial Action Task Force. The work of the Security Council sanctions committees is critically assessed in a number of areas including their failure to overcome differences and conflicts in domestic legal and regulatory approaches. Differences in corporate law, jurisdictional principles and the authority of regulators to impose civil sanctions outside traditional judicial channels have created significant obstacles that hinder cross-border implementation and enforcement efforts. For instance, lack of generally accepted legal safeguards to prevent individuals from being unjustly designated on Security Council blacklists raises human rights issues and undermines the willingness of many national authorities to recognise and enforce these designations. The chapter argues for more convergence and harmonisation in applying principles of jurisdiction, third party liability, and financial regulation.

The book suggests that international efforts and institutional reforms should build on existing bilateral and multilateral agreements and institutions to co-ordinate sanctions implementation. National sanctions programmes should focus on the gaps in existing corporate law and territorial jurisdiction which allow companies and investors to circumvent sanctions restrictions. It evaluates US unilateral economic sanctions as more threat than promise and proposes increased linkages between US sanctions regulators and EU regulators. Although historically the US could justify its 'go it alone' approach because international institutions were often ineffective in administering sanctions programmes, US policymakers have failed to work effectively with the EU and other countries in developing an accountable and legitimate multilateral sanctions regime. Based on the case of North Korea, the study suggests that future sanctions initiatives should take place

primarily through regional initiatives based on bilateral agreements for the exchange of information and coordination in the application of sanctions measures. Nevertheless, the Security Council should continue to have an important role to play in setting the political agenda for international sanctions, but responsibility for implementation and administering sanctions programmes should be shifted away from the Security Council sanctions committees to other international economic organizations such as the World Bank. More bureaucracy at the UN, for example by establishing a UN sanctions agency, is not the answer to the problem of effective implementation at the national level. Public policy should be focused on devising the necessary domestic legal techniques and regulatory practices to achieve the objectives of sanctions programmes. The legal and regulatory framework may vary from state to state depending on different institutional structures, but there should be more effective bilateral and regional coordination, and states should have clear objectives when adopting sanctions and express conditions for when they will be lifted or modified.

1

The Origins and Use of Economic Sanctions

Neither war nor economics can be divorced from politics; each must be judged as an instrument serving the higher goals of the polity.

David Baldwin, *Economic Statecraft* (1985) p. 65

To Sanctions of an economic character we will reply with our discipline, with our sobriety, and with our spirit of sacrifice¹

Mussolini

Introduction

The use of economic sanctions has throughout history been an integral component of the foreign policy of most nation-states. Nations have relied on economic sanctions not only to influence foreign policy and national security objectives but also to respond to domestic political needs and economic pressures. In antiquity and in early modern Europe, economic sanctions were used for a variety of purposes but mainly as subordinate instruments of military policy during times of war.² Indeed, Athens imposed economic sanctions in 432 BC when Pericles issued the Megarian import embargo against the Greek city-states which had refused to join the Athenian-led Delian League during the Peloponnesian War.³ During the religious wars of Europe's reformation, states used trade embargoes and other economic sanctions to compel compliance with treaty obligations to protect certain Christian minorities.⁴

¹ See Renwick (1981, 18).

² The Roman Government imposed a virtual trade embargo on the Gauls between 232–225 BC which forbade anyone (including non-Roman citizens in third countries) from buying or selling gold or silver with the Gauls. See Harris (1975, 198, n. 3).

³ Pericles, *History of the Peloponnesian War* (transl. by Rex Warner) (Penguin Books, 1973) 118–122.

⁴ In 1531, some Swiss protestant cantons led by Zurich prohibited the sale of flour, salt, iron and wine to the catholic cantons because the catholic cantons had breached

In the late nineteenth century, economic sanctions were generally used during times of war and took the form Export controls on strategic supplies and blockades against targeted countries (Medlicott, 1952, 9).

The use of economic sanctions outside of war was not generally adopted by major states until the 1920s following the enactment of the League of Nations Covenant, which authorised the use of economic sanctions against countries which had committed military aggression against other states. Although the League used the threat of economic sanctions to resolve several border disputes in the 1920s,⁵ it was much less successful in using sanctions to deter larger, more powerful states from engaging in aggression. Indeed, the sanctions imposed against Italy for invading Abyssinia in 1935 were limited in scope and applied only to military armaments and certain commercial transactions, not to oil sales or other areas of international trade. Similarly, the League threatened, but never imposed, sanctions against Japan for its invasion of Manchuria in 1931, thus further undermining its credibility to deter aggression. The lack of political will in the League to establish an effective economic sanctions regime and the failure of the US to provide any meaningful support portended the League's demise.

In contrast, during both the First and Second World Wars, Great Britain and the US adopted strict export controls and asset blocking orders against the Axis powers and their controlled entities and persons (Malloy, 2001, 33–38; Domke, 1943, 120–127). Many of these economic controls were maintained in the immediate aftermath of the Second World War and in the case of the United States were later extended into a comprehensive system of economic and financial restrictions against communist countries and other states of concern and international terrorists (Malloy, 2001, 39–46; Fitzgerald, 1999, 88–89). Following the attacks on the US on 11 September 2001, a vast international regime of economic and financial sanctions has been adopted against international terrorists and the entities which support them. The purpose of this chapter is to place the use of economic sanctions in historical perspective and to address some of the questions regarding why countries adopt economic sanctions and how they have been generally used and applied to accomplish foreign policy and national security objectives. The chapter will also examine the evolving role of international organisations in using economic sanctions to promote collective security objectives.

their obligations under the First Kappel Peace Treaty of 1529 to tolerate minority protestants. This precipitated a civil war in 1531 that culminated in the Second Kappel Peace Treaty (1531) that restored some religious liberties in the Swiss cantons for both catholics and protestants (Bader and Bangerter, 2001, 18–20).

⁵ In 1921, League members successfully imposed limited sanctions against Yugoslavia to deter Greece from taking territory from Albania, and in 1925 used the threat of sanctions to persuade it to withdraw from Bulgarian territory.

I Nature and purpose of economic sanctions

The basic purpose of economic sanctions throughout history has essentially remained the same, namely, restricting foreign trade and finance or withholding economic benefits such as state aid from targeted states or other targeted non-state actors to accomplish broader security or foreign policy objectives. In assessing the effectiveness or utility of a sanctions policy, it is necessary to define its objectives and to have measurable criteria for determining whether the objectives have been met. An effective sanctions regime also requires coherent legal principles and rules that allow sanctions to be implemented in a consistent and equitable manner. Legal doctrine and regulatory technique are important for achieving the public policy objectives of economic sanctions.

Economic sanctions can have any combination of the following objectives: *behaviour modification* of the target, *retribution* or *punishment*, or as a *signal* to the target or to other third country states. Moreover, the rationale of economic sanctions may involve promoting military objectives on the one hand, and maintaining peace on the other. Or it may involve the use of sanctions as a means of *containment* and/or *dialogue*. Some of the tactical policy objectives of sanctions can be to deter or coerce the target, or to deter or coerce other states or persons who are not directly the target of the sanctions but who trade or do business with the target. Some international tribunals have raised the issue of whether sanctions are exemplary in character.⁶ According to this view, sanctions are 'penalties' that cannot be lifted or reversed: they are punitive. This narrower definition would not cover most types of economic sanctions, such as financial asset blocking or freeze orders or export controls, which can be lifted or reversed in response to a change in behaviour of the target country (Zoller, 1985, 37–38).

Deterrence and coercion can take the form of actual or threatened economic sanctions and can take a positive and negative form. Positive sanctions can involve a state promising to grant enhanced access to its markets or to increase its foreign aid to another country in return for it making specific policy changes or continuing to follow an existing policy.⁷ Negative sanctions involve actual or threatened measures that impose costs or withhold benefits from a targeted state for pursuing or failing to pursue a certain policy. Positive sanctions are becoming more commonly used in foreign policy negotiations. For example, as part of the six-party talks in 2007 over

⁶ See *Air Service Agreements Award* (1978) arbitral tribunal observed whether the purpose of the US remedy or sanction was exemplary in character and 'directed at other countries and, if so, did it have to some degree the character of a sanction' 18 U.N.I.A.A. 442, sec. 78.

⁷ Baldwin (1985, 20) discusses the various dimensions of positive and negative economic sanctions.

North Korean nuclear disarmament, an important incentive for North Korea in agreeing to denuclearise its key nuclear facilities was the promise of aid in the form of one million tons of heavy fuel oil, grants and technical assistance. Similarly, positive sanctions have also played a significant role in the negotiations between the Security Council and Iran over its uranium enrichment programme. An optimal economic sanctions policy should rely on a combination of both positive and negative sanctions, while recognising that the right mix will vary depending on the circumstances of each case.

Since the early 1990s leading states have increasingly used economic sanctions as part of broader multilateral or regional sanctions programmes either through the United Nations Security Council, the European Communities or other regional bodies. Moreover, sanctions have been authorised increasingly against non-state targets – business entities and individuals – and against legitimate business enterprises and investors who do business with these sanctions targets. The increased reliance on multilateral sanctions by the Security Council and on unilateral sanctions by the US and European Communities raises important economic and legal issues regarding the capacity of states to impose sanctions and to use them to achieve foreign policy or national security objectives and the impact of sanctions on international business activity and the regulation of companies and financial markets. For instance, what type of legal and regulatory techniques are being used to implement economic sanctions and what type of constraints do they impose on legitimate businesses and investors who have commercial relationships with the sanctions' targets?

The legal instruments through which sanctions policy is implemented can take a variety of forms. Some states adopt statutes that specifically proscribe certain activity, while other states adopt legislation that delegates authority to regulators and government agencies to craft specific rules, requirements, and conditions that must be satisfied to allow certain restricted transactions and also to provide exemptions and exceptions for other types of transactions. The accountability and legitimacy of a state's sanctions programme can be tested in part by how transparent its statutory provisions and regulatory rules are in a procedural and substantive sense. Procedural transparency requires regulatory rules to be publicly available and subject to input from all stakeholders who have had the opportunity to monitor or influence their promulgation. Substantive transparency means that the objectives or purpose of the sanctions are set forth clearly in statute or regulation and the specific behavioural expectations of the target are clearly stated along with the contingencies that must occur for the sanctions to be lifted. Moreover, substantive transparency can be evaluated in terms of what type of procedural safeguards are in place for individuals and businesses subject to sanctions controls to challenge their application.

States may draw on different legal doctrines to impose sanctions and related controls on particular transactions and persons. For instance, some

states rely more on expansive notions of extra-territorial jurisdiction to apply controls and restrictions on parties operating in foreign jurisdictions, while other states adhere to stricter notions of territorial jurisdiction in applying sanctions to persons and transactions in their territory doing business with targeted states or entities. Sometimes states act in concert by coordinating the application of their sanctions laws and policies against targeted states. During World War II, the British and US governments coordinated their export control legislation and asset blocking regulations adopted pursuant to each country's trading with the enemy legislation to wage economic warfare against the Axis alliance (Domke, 1943, 24–51).

II Economic sanctions – historical perspective

Throughout history states have used economic sanctions or controls to achieve political, economic, or ideological objectives. During times of war, states used sanctions primarily to reduce the economic strength of targeted states. Economic strength was considered a vital component of state power and in the course of war it was an accepted target of attack by military as well as economic means (Carr, 1946, 113). Economic strength, however, was not the only target of a state's sanctions programme, as sanctions were also used to signal political messages to a target state or to allied states or neutral third country states who were potential sanctions targets. The signalling aspect of sanctions was important because they could be used to convey a message, for instance, that tensions were escalating between two countries and that alternative policies were needed to avert military conflict.

If military conflict did occur, countries usually resorted to traditional embargo tactics that could be enforced by military blockade or siege (Rothernberg, 1986, 324). In the nineteenth century, the use of blockades increased as states developed their sea power and naval warfare capabilities which could be used to target the economic strength of enemy states over a period of time. Naval blockades often led to enemy ships being captured or destroyed, or they could prevent them from calling at enemy ports to discharge or collect cargo. In addition to prohibiting trade with the enemy and destroying its shipping, most belligerents claimed the right of search and visit of neutral ships on the high seas for goods destined for enemy use and directly related to its war efforts.

In pre-independence America, the first significant US economic sanctions took the form of a boycott in 1765 during the Stamp Act crisis involving the colonists boycotting English goods in response to Parliament's passage of the Stamp Act (O'Brien, 1997, 40–46). The British government responded by repealing the Stamp Act in 1766, but later enacted the Townshend Act which imposed duties on the colonies to cover the salaries of colonial governors and judges. The colonists retaliated by re-imposing the boycott against English goods, which led ultimately to the Boston Tea Party of December

1773 (Miller, 1962, 109–162). Later, during its early years as an independent country and at the height of the Napoleonic wars in Europe, economic sanctions became an important component of US foreign policy. Between 1794 and 1809, Congress enacted various statutes that vested discretion with the president to impose embargoes on all ships and vessels in US ports and to suspend or restrict trade and commercial relations with other countries (Malloy, 2001, 34). In 1807, President Thomas Jefferson relied on what became known as the non-intercourse acts to impose trade embargoes against many countries by specifically prohibiting US ships from departing for foreign ports and prohibiting the transport of US goods by foreign country vessels. The stringent nature of the embargo caused significant political opposition within the country, thus leading to its repeal in 1809. In 1811, British-American tensions were reignited when the UK government adopted a policy of intercepting US ships on the high seas which were trading with France, with whom Britain was at war. The US government responded by imposing a complete embargo with England, which precipitated the War of 1812.

During the Napoleonic wars, the British and the French each used economic blockade on a broad scale. The intent of the belligerents in adopting economic blockade was not so much directed at destroying munitions industries, but at causing commercial ruin and food shortages through the dislocation of trade. The British objectives of complete economic isolation of French-controlled Europe met with limited success (Jack, 1940, 1–42). Although British sanctions imposed a great economic cost on continental Europe, they were not adequate in themselves to disable the French economy which was largely self-sufficient regarding food and other raw materials. The relative success, however, of blockade and trade controls by both the British and French during the war suggested wider possibilities for using economic controls and sanctions in the future (Doxey 1980).

In the nineteenth century, the US government restricted the use of economic sanctions to times of war or in special emergency situations (Berman and Garson, 1967). For example, during the American civil war, the Union government in Washington ordered a blockade of coastal southern states which had seceded (Bemis, 1942, 159). Later, in 1898, during the Spanish-American war, Congress passed a joint resolution authorising the president to ‘prohibit the export of coal or other material used in war’ in connection with the war against Spain.⁸ Relying on this authority, President Roosevelt, in the aftermath of the Spanish-American war, imposed an embargo against the Dominican Republic in 1905; this marked the beginning of a policy of applying arms export restrictions and economic sanctions in order to promote political stability and US interests in Latin America and China (Atwater, 1941, 18–19).

⁸ Cong. J. Res., Apr. 22, 1898, No. 25, 30 Stat. 739.

Investment in international trade offered new opportunities for the use of economic sanctions. Some industrial countries such as Britain and Belgium were extremely vulnerable to interference with their imports of food and raw materials. Further, by the early twentieth century, advances in technology led to the mechanisation of warfare that made traditional techniques of combat obsolete (Doxey, 1996, 21–22).⁹ For an industrial power to sustain a successful war effort, it would need access to raw materials, iron-ore, petroleum and other commodities. Thus, access to foreign markets was important, and military success could depend on a nation's ability to circumvent an economic blockade and other economic controls. Because of improved military technology, the scope of war was extended beyond the actual area of combat to other areas of economic and social life. Even neutral states found it impossible to remain insulated while maintaining normal patterns of economic life (Ibid).

As a result, many nineteenth-century rules of war governing blockade and economic warfare became obsolete by the early twentieth century (Elagab, 1988, 31–34). The traditional rules of customary international law limiting a belligerent's blockade to the enemy's coastline and ports were ineffective in an age of submarine and air warfare, and distinctions between different types of contraband became meaningless when nations began mobilising all resources as part of the war effort. Moreover, increased global trade and investment made it easier for enemy states to circumvent economic embargoes by trading through neutral or so-called third countries that were not at war in order to circumvent direct economic restrictions between enemy states. It also became necessary for enemy states to monitor more closely the trading and investment activities of third country nationals and business entities who had seized opportunities to do business with enemy states which were in need of strategic and non-strategic goods and services that could sustain their economies during wartime.

Economic sanctions during World War I

The technique of economic warfare which developed during World War I was vastly different than anything that had developed before, and proved to be far more effective.¹⁰ A central feature of the Allied powers' economic blockade of Germany and Austria was the extra-territorial economic

⁹ Doxey's study provides a penetrating analysis of the history of economic sanctions and the political motives that underpin their application.

¹⁰ Medlicott noted that in 'its widest application the term "economic warfare" covered three means of defeating the German economic effort – blockade, counter production, and attack behind the enemy's fighting front...At no stage of the war was Germany decisively weakened by shortages due to the blockade alone.' See Medlicott (1952, 130–31).

sanctions that were directed against neutral countries that were trading with Germany (Ambrosius, 1991; Medlicott, 1952, 46–52).

British blacklisting and secondary boycotts

The UK government announced the imposition of comprehensive economic sanctions and a blockade of Germany in March of 1915 as a reprisal for German submarine warfare.¹¹ The allied powers had considered German trade with neutral countries to be an economic target of prime importance and therefore targeting third country persons who were trading with Germany became an important economic weapon for the British government. British Intelligence introduced a system of ‘blacklisting’ the names of persons or entities of neutral third countries who were known or suspected of acting on behalf, or for the benefit, of the Germans (Medlicott, 1952, 15–23). The British government banned all trade with these black-listed entities and prohibited neutral countries from permitting British-origin goods to be re-exported to such entities. In addition, Britain’s wartime blockade effort also included agreements with neutral governments and trade associations that British goods would not be re-exported to Germany and her allies. To this end, the British government undertook the following measures: restricting the imports of certain neutral countries which were suspected of trading with Germany; the ‘blacklisting’ of private entities or persons in neutral countries who were suspected of having – or were known to have – enemy connections and with whom dealings of any kind were consequently prohibited; and the refusal or threat of refusal of using English port facilities to engage in enemy trade. Moreover, British Intelligence monitored the global trading activities of all UK persons, wherever they resided. Indeed, this type of blockade had a different and broader scope from the blockades that had been implemented in the Napoleonic wars: the old-style direct naval blockade of the enemy coast had given way to a new style of blockade enforced at long range through control of contraband and by imposing extra-territorial sanctions against neutral states and their nationals for trading with the enemy (Guichard, 1930, 28–32).

¹¹ See Trading with the Enemy Act 1915 §§ 2–4. The blockade covered all German trade, ignoring distinctions between types of contraband. Enforcing the blockade was difficult because of the hazards of inspecting ships on the high seas. The examination of neutral shipping was conducted in ‘control ports’ which caused considerable delays in shipping. The British government and its neutral trading partners thereby adopted a system of navicerts, which were documents that certified a neutral destination for goods; they were issued at source and thus eliminated the need for further inspection of cargoes at sea. See Jack (1940, 93–95) and Medlicott (vol. ii, 1959).

US blacklisting

Before its entry into the war, the United States had insisted on its rights as a neutral country and had objected to the extra-territorial application of British export controls and economic sanctions as a violation of US sovereignty and as a serious inconvenience to US traders.¹² After it entered the war, however, the United States began co-operating with the British government in enforcing the embargo against the German-led alliance and by enacting its own embargo legislation, the Trading with the Enemy Act of 1917, which contained essentially the same types of economic controls and restrictions as the British had imposed. Moreover, the US adopted the British tactic of using the threat of economic controls and sanctions with neutral countries as a bargaining tool to convince them to adopt similar trade restrictions against the German alliance (Doxey, 1971, 18) (Guichard, 306).

Most historians recognise the Allied blockade as being an important factor in defeating Germany (Shaw, 1940, 35–40). The effectiveness of the Allied blockade depended in part on the high level of co-ordination between UK and US regulators and enforcement authorities and their recognition and enforcement of similar legal principles of liability for persons trading or investing in breach of the economic controls. Moreover, the allied blockade was primarily responsible for causing German exports and foreign investment to decline by over 80 percent during the course of the war.¹³ Generally, the use of blacklisting and other extra-territorial measures by the UK and US governments against third country trading with the German alliance were considered effective means of economic warfare.

Sanctions during World War II

As discussed above, during the inter-war period, economic sanctions that were adopted under the auspices of the League of Nations were largely ineffective in persuading invading states to cease their aggression. One reason for their ineffectiveness was the lack of co-ordination between states in imposing sanctions and their failure to apply similar legal principles of liability and by coordinating regulatory practices. Differences in law and

¹² See Jack (1940, 87, 90–93, 100). The US had proposed that the Declaration of London of 1909 be applied to shipping rights of neutrals; the UK objected because it regarded the contraband rules as too lenient; but the US proposal was accepted by Germany. Between 1914–16, the US submitted protests against British restrictions. On 20 February 1915, US proposed new rules concerning the use of mines and designation of contraband, but proposals were rejected by UK and Germany. See also, Pratt (1955, 24–27).

¹³ On the other hand, other commentators, such as Medicott, considered the effects of the blockade to have been exaggerated, which resulted in too much value being placed on economic pressure as a means of maintaining international peace (Medicott, vol. ii (1959) 633).

regulation and in political will between states resulted in poor oversight by League members and inadequate implementation into national regulation and administrative law. In contrast, Allied economic sanctions in World War II were far more effective than the sanctions imposed by the League during the inter-war years primarily because decision-making was more concentrated amongst the Allied powers, more realistic policies of targeting the strategic supplies of the Axis powers were adopted, and extra-territorial jurisdiction was imposed on third country trade with targeted states. These sanctions policies were effective, in part, in achieving their objective of economically isolating the axis powers because they were based on coherent statutory measures that governed the application of legal liability and facilitated inter-state coordination and surveillance of target state commercial activity.

British blacklisting during World War II

Before the US had entered the war in 1941, the British government had adopted an effective national economic sanctions programme directed against the Axis powers. The British Ministry of Economic Warfare implemented a blockade plan which formed part of a wider programme of unrestricted economic warfare which included the concentrated bombing of industrial targets in Germany. British import controls reduced Germany's exports to the UK by 80 per-cent in two months (Medlicott, 1952, 332–336). Unlike the First World War, the interception of products destined for German markets on the high seas was less important than controls exercised at the source which, through the use of blacklisting and shipping warrants, prevented goods destined for the enemy from being shipped at all.¹⁴ After the US entered the war, the British and US governments made extensive use of blacklists. The British Ministry of Economic Warfare adopted a broad programme of unrestricted economic warfare, which included the bombing of German industrial targets and the use of export controls on trade with neutral countries. The techniques devised in the First World War were developed and refined. For example, the blacklisting process was more comprehensive because it provided more details about the financial assets and trading habits of third country nationals who were acting on behalf of the Axis powers. For example, the Board of Trade issued four orders in the earlier stages of the war pursuant to the 1939 Trading with the Enemy Act that established a 'Black List' containing over 650 names that included companies and banks which were deemed enemies.¹⁵ British nationals were warned

¹⁴ Without a ship warrant, a shipper could not use British facilities or ports. See Doxey (1980, 13).

¹⁵ See The Trading with the Enemy (Specified Persons) Order of 13th September 1939 (S.R. & O., 1939, No. 1166); see also The Trading with the Enemy (Specified

not to have any dealings with these persons without obtaining a licence from the Trading with the Enemy Branch of the Board of Trade.¹⁶

US blacklisting

In contrast to World War I, US co-operation with the British in enforcing the embargo and blacklisting mechanism began in 1939, nearly two years before the US entered the war. Throughout the war, the US economic embargo relied principally on the control of foreign funds and the licensing of exports to neutrals. The US also instituted a proclaimed blacklist to address the problem of 'corporate cloaks' and 'fronts' operating for the Axis powers. The blacklist was called the 'Proclaimed List of Certain Blocked Nationals'.¹⁷ When President Roosevelt issued this list in 1940, he declared:

[a]ny person so long as his name appears in such list, ... shall be treated for all purposes under Executive Order No. 8389 as though he were a national of Germany or Italy. All the terms and provisions of Executive Order No. 8389 ... shall be applicable to any such person so long as his name appears in such list, and to any property in which any such person has or has had an interest, to the same extent that such terms and provisions are applicable to nationals of Germany or Italy and to property in which nationals of Germany or Italy, have or have had an interest.¹⁸

The US Treasury Department later recognised that 'from the inception of the freezing program that a control which could reach only those who were actually citizens of the Axis countries or of other countries under their domination would be ineffective, and, indeed, naive in the light of Axis practices' (US Treasury, 1942, 32–33). Treasury Department officials designed the blacklist programme 'so that anyone entangled in the web of Nazi influence could be subjected to the control' (Ibid.). As in World War I, UK and US cooperation and co-ordination in applying economic and financial sanctions to Axis states, their business entities and nationals, and to third country neutral entities with whom Germany and their supporters were trading resulted in effective oversight of sanctions programmes by Allied countries. Moreover, the application by US, English and other allied country courts of similar principles of civil and criminal liability for holding businesses and individuals responsible for trading with enemy states provided an effective

Persons) (Amendment) (No. 4) Order of 23rd December, 1939 (S.R. & O.) (1939, No. 1875).

¹⁶ For a detailed discussion of the British wartime economic sanctions during the First World War, see Trotter, p. 662.

¹⁷ See Exec. Ord. No. 8785 § 5E, 6 Fed. Reg. 2898 (1941). See also Domke (1943, chs. X & XI).

¹⁸ Proclamation No.2497, § 2, 6 Fed. Reg. 3555 (1941).

legal basis for the enforcement of sanctions on a cross-border basis. Nevertheless, jurisdictional gaps existed in the application of sanctions to cross-border trade and finance because of different notions across countries of extra-territorial jurisdiction and control liability for business entities.

In both the World Wars, Great Britain and the US relied on trading with the enemy statutes and other emergency legislation and regulations to impose strict export controls and asset blocking orders against the Axis powers and their controlled entities (Domke, 1943). These controls were maintained throughout the war and in its immediate aftermath and were later transformed into export controls against communist bloc countries (Domke, 1947, 39–46). During this period, British and US bilateral co-operation was generally viewed as effective in applying extra-territorial trade controls and financial sanctions against neutral third country persons and entities doing business with Nazi Germany and its allies. The Allied experience during World War II demonstrated that a comprehensive and effective economic sanctions regime requires cross-border co-ordination between state policymakers and regulatory authorities in devising the type of sanctions to be targeted against enemy states and their nationals and business entities, and in overseeing their implementation into domestic regulation and enforcement. Later experience with some United Nations economic sanctions programmes showed that without effective legal and regulatory controls and inadequate cross-border co-ordination between countries that economic sanctions can fail to achieve their stated objectives and be undermined with near impunity.¹⁹

Following the war, the US maintained a comprehensive legal and regulatory regime governing export controls and more general economic sanctions (including asset blocking orders) against Soviet-bloc states and communist states in Asia (Malloy, 2001, 39–52). Similarly, the UK consolidated their wartime export controls into more comprehensive export controls based on the principles of the Co-ordinating Committee for Multilateral Export Controls (CoCom) which governed NATO and western allies' export practices during the Cold War. However, in the aftermath of World War II, the UK government phased out the core of its economic sanctions programmes that were composed mainly of asset blocking orders and blacklists that had been in place during the war.

Since their inception, US Treasury Department blacklists have been tools for economic warfare (Kendrick, 1990). Indeed, the Treasury Department's Office of Foreign Assets Control (OFAC), which has responsibility for issuing blocking orders and implementing US blacklist programmes since 1966,

¹⁹ This was the case with United Nations economic sanctions against Southern Rhodesia that took effect in 1966 and continued until 1979 which suffered from widespread evasion by multinational companies and traders and poor implementation and enforcement by UK and US authorities. See discussion below.

considers itself as carrying out essentially a wartime mission and views itself as an enforcement agency. OFAC economic sanctions programmes have been at the heart of US sanctions policy and have driven international sanctions policy against terrorism in the post-9/11 era.

Most historians view Allied sanctions as successful in accomplishing their objectives of imposing substantial costs on targeted Axis states and thereby enhancing the war effort (Cohen, 1950, 22–26). Although the Allied powers followed a multilateral approach to implementation and enforcement of their financial sanctions regulations, various inconsistencies and gaps emerged in regulatory technique and legal principle that undermined the effective implementation of the sanctions programmes. For instance, different notions of jurisdiction and concepts of control liability for corporate enterprises and business entities divided Allied financial sanctions policies. The problems confronting wartime policymakers in designing effective sanctions programmes continue to provide policymakers with similar challenges today in devising an effective international economic sanctions regime and for better understanding the weaknesses of many national programmes.

III International organisations and economic sanctions

International organizations and regional institutions have significantly impacted state economic sanctions practice by requiring states to adopt sanctions in many circumstances and by fostering co-operation amongst states in the implementation and enforcement of sanctions. International organizations, however, have faced tremendous obstacles in ensuring that states implement sanctions effectively and criticism that sanctions are ineffective instruments of foreign policy and should only be used selectively and sparingly because of the social costs they impose and potential human rights concerns. This contrasts with the enthusiasm and spirit of co-operation that animated the founders of the League of Nations in 1919. The disastrous social and economic toll taken in the First World War convinced many countries that economic sanctions were the only acceptable method for nations to use during times of conflict. The League's Covenant prohibited League members from engaging in commercial relations with any other members that resorted to war. President Woodrow Wilson believed strongly in the efficacy of economic sanctions to maintain peace and stability in the international system and to enforce important principles of international law. Wilson argued that a disciplined adherence to economic sanctions by all League members would deter most countries from using military aggression (Pratt, 1955, 45–48).

The League of Nations

The origin of modern economic sanctions as an instrument of collective security can be found in the negotiations that led to the Paris Peace

Conference of 1919 that approved the Covenant of the League of Nations. French negotiators were concerned that the League would become an international body that could take decisions but not enforce them. The French premier Georges Clemenceau wanted to delegate authority to the League so that it could take effective action to prevent aggression and in particular to maintain a security guarantee against a resurgent German military threat (Ambrosius, 2002, 52). Indeed, the French foreign ministry had accepted the recommendations of a commission headed by Leon Bourgeois which had proposed that the League should have the ability of applying effective military, judicial and economic sanctions against members which had committed aggression. On the other hand, US President Woodrow Wilson's proposal for a security guarantee was set forth in Article 10 of the League Covenant, which created an obligation for League members to respect the territorial integrity and political independence of other states, but was not accompanied with effective implementation or enforcement measures.²⁰ Wilson envisioned that states would have a moral, not a legal, obligation to enforce the security guarantee against an aggressor state.²¹ Wilson's view prevailed as the Covenant ultimately provided for a voluntary approach for member states to decide, based on a unanimous recommendation of the League Council, whether they want to take military or economic measures against a member that had committed aggression. There was no obligation for League members to implement the recommendation (Ibid., 55).

Although the League Covenant did not make the use of military force a breach of the Covenant in all circumstances, it imposed constraints on the legitimate and lawful use of force by states. If a state used force in breach of the Covenant, the League was authorised to take military sanctions against the violating state, but only if there was a unanimous vote of the League Council that the state in question had violated the Covenant and that military sanctions should be imposed. Any military measures thus imposed had to be necessary and proportionate and used 'for the maintenance of right and justice'²² and 'to protect the covenants of the League.'²³

Regarding economic sanctions, Article 16 of the Covenant provided for commercial and financial sanctions to apply automatically to any member who commits an act of aggression without first attempting to settle its

²⁰ Article 10 of the Covenant required League members to 'undertake to respect and preserve as against external aggression the territorial integrity and existing political independence of all Members of the League.'

²¹ Ambrosius (2002, p. 53) quotes Wilson at a meeting of the League Commission as stating '[a]ll that we can promise, and we do promise it, is to maintain our military forces in such a condition that the world will feel itself in safety. When danger comes, we too will come, and we will help you, but you must trust us. We must all depend on our mutual good faith.'

²² Art. XV(7)

²³ Art. XVI(2)

dispute peacefully through either arbitration, the international court of justice, or the League Council.²⁴ States were obliged to refrain from acts of aggression until after one of the three prescribed methods of peaceful dispute resolution had been tried.²⁵ The only obligation for League members therefore was that they attempt to settle their dispute through one of these three methods. Economic sanctions could only be imposed automatically against a state which had failed to submit its dispute to arbitral or judicial settlement before resorting to force (Ambrosius, 1991, 127). If a state submitted its dispute to arbitration and later was ruled against, it could then lawfully resort to force. Wilson believed, however, that the weight of international opinion and League political pressure would prevent a state from using force if it was not successful in peaceful dispute resolution.

The League Covenant's policy objective of imposing sanctions against a state which uses force without first resorting to arbitral or judicial settlement, however, was not supported by an adequate adjudicatory framework. The Covenant only provided that all League members voting unanimously in the League Council could decide that a state had breached its obligations and only then would all League members have an obligation to impose trade and financial sanctions. Kelsen (1950, 706–707) called into question the legal validity of the League's sanctions regime on the grounds that the Covenant authorised no centralised authority to adjudicate whether a state had breached articles 12–15 and whether a sanction should be imposed. He argued that there was a gap in enforcement because article XVI did not specify who is to judge if a breach had occurred (Ibid.). He observed that although the literal meaning of Article XVI provides that sanctions will be imposed automatically if a state breaches an obligation under articles 12–15, a sanction cannot simply be imposed, as there must be a judicial adjudication that the law has been violated, and only then can a sanction be applied. As a result, he argued, each member was required to make the determination as to whether a breach had been committed, and only in that event was the member obligated to apply sanctions listed in Article XVI (Ibid.). Because League members individually retained the authority to adjudicate whether

²⁴ Article XVI paragraph(s) 1 & 2 provides:

(1) Should any member of the League resort to war in disregard of its covenants under Article XII, XIII, or XIV, it shall ipso facto be deemed to have committed an act of war against all other Members of the League, which hereby undertake immediately to subject it to the severance of trade or financial relations, the prohibition of all intercourse between their nationals and the nationals of the Covenant-breaking state, and the prevention of all financial, commercial or personal intercourse between the nationals of the Covenant-breaking state and the nationals of any other state, whether a Member of the League or not.

²⁵ Art(s) XII–XV.

a Covenant violation had occurred, they also retained sole authority to decide whether economic sanctions should be imposed.

Despite this considerable flaw identified by Kelsen, the use of economic sanctions by the League in the 1920s met with some success when applied against smaller powers (Hufbauer *et al.*, 1985, 124–131). Acting under Article 16, the League threatened to impose sanctions against Yugoslavia in 1921, serving as a primary inducement to cease its military efforts to acquire territory from Albania. Similarly, the League's threatened use of sanctions in 1925 was an important factor in Greece's decision to withdraw from its occupation of Bulgarian territory (*Ibid.*). Later, however, in the 1930s, the effective use of economic sanctions to maintain peace was severely undermined by the League's weakness in response to Italy's invasion of Ethiopia in 1935. The arms embargo approved by the League against Italy was selective in nature, as it imposed trade and financial sanctions but failed to embargo the export of strategic materials such as petroleum, coal, steel, and pig iron. Moreover, major League members, such as Great Britain, though it adopted measures to conform British export law with League sanctions, failed to enforce these laws adequately and continued to supply oil to Italy (Thomson, 1981, 203).²⁶ As a result, the embargo exerted insufficient pressure to persuade Italy to withdraw its forces. In addition, major non-League states, such as the United States and the Soviet Union, refused to adhere to League sanctions and adopted no binding controls on exports, whilst other member states of the League, such as Germany and Spain, failed to adhere to the embargo in any meaningful sense. Because no leading power was willing to adopt effective measures to enforce sanctions against Italy, the embargo failed to achieve its objective of deterring Italian aggression.

In a juristic sense, it may be said that the League's sanctions regime failed because there was no adjudicatory framework, nor were there any enforcement procedures, to ensure a consistent process for determining facts and for enforcing decisions. Notwithstanding its ineffectiveness in preventing aggression by the Germans, Italians and Japanese, the Covenant of the League is recognised as a revolutionary development in the law of nations, as it was the first instance where specified acts were prohibited and a general sanction or penalty imposed for violation of a multilateral agreement which a large number of states had agreed to adopt.

United Nations

The drafters of the United Nations Charter, working while World War II was still in progress and under the shadow of the ill-fated League of Nations, provided for two principal organs for the new organisation: (1) the General

²⁶ Prime Minister Stanley Baldwin was reported to have said, in response to Foreign Minister Samuel Hoare's query about enforcing sanctions against Italy: 'Keep us out of war, Sam: We are not ready for it' (Thomson, 1981, 204).

Assembly (composed of every UN member state), and (2) the Security Council (initially composed of eleven nations, represented today by fifteen nations, including five permanent members and the others serving rotating terms of two years each). The General Assembly has authority to pass legally non-binding resolutions that recommend that member states adopt economic sanctions, whereas the Security Council has authority to pass both legally non-binding 'recommendations' and binding 'decisions' to impose sanctions. The General Assembly's first resolution recommending sanctions was in 1946 against Spain and its fascist government led by General Franco.²⁷ Later, the Assembly and Security Council passed a number of resolutions condemning the apartheid regime of South Africa and recommending that states impose an arms embargo and certain trade restrictions against South Africa.²⁸ Although these resolutions were legally non-binding, they played an important role in focusing international attention on the human rights abuses of apartheid and the threat to peace and security it posed for the region.

The Security Council has the authority²⁹ to pass resolutions that can take a number of forms pursuant to Chapters VI and VII of the UN Charter. In the case of economic sanctions, the Security Council can adopt 'recommendations' under Chapter VI, or take legally binding 'decisions' under Chapter VII. Chapter VI of the Charter, dealing with the peaceful settlement of disputes,³⁰ authorises the Security Council to 'call upon' the parties,³¹ to 'investigate',³² to 'recommend appropriate procedures or methods of adjustment',³³ and to 'make recommendations to the parties'.³⁴

In contrast, Chapter VII of the Charter, dealing with 'Action with Respect to Threats to the Peace, Breaches of the Peace, and Acts of Aggression', refers solely to the powers of the Security Council. But though Article 39 states that a condition precedent for application of Chapter VII is a determination by the Security Council of the existence of a 'threat to the peace, breach of the peace, or act of aggression,' the same article leaves open the possibility either of recommendations or of decisions by the Security Council. Such decisions taken under Chapter VII include measures not involving the use

²⁷ GA/Res/39(I) (12 Dec. 1946).

²⁸ GA/Res/1761 (6 Nov. 1962); S/Res/181 (7 Aug. 1963).

²⁹ The allied powers agreed at Yalta in 1944 that collective decisions and action in the area of international peace and security should not be taken without the agreement (or at least abstention) of the major powers. The UN Charter, therefore, granted each of the permanent members of the Security Council the right to veto any resolution other than one on procedural grounds. Art. 27, UN Charter.

³⁰ Art(s) 33–38, UN Charter.

³¹ Art. 33, UN Charter.

³² Art. 34, UN Charter.

³³ Art. 36, UN Charter.

³⁴ Art. 38, UN Charter.

of force, such as economic sanctions,³⁵ and measures that do involve the use of force.³⁶ Accordingly, if the Security Council determines a breach or threat to the peace, or act of aggression, it can authorise the use of economic sanctions by its members on a multilateral basis with co-ordination provided by the Security Council. The language in Article 39 is broad and, according to some experts, provides the Security Council discretion to determine what is a threat to the peace (McDougal & Reisman, 1968, 1; Yoshimura, 2008). Practically, the restraint on Security Council action to impose economic sanctions lies more in the requirement that nine of the 15 members of the Security Council must vote for the action, rather than in any particular factual determination of an actual or potential threat to international peace and security.

The first effort by the UN Security Council to impose economic sanctions was in 1966 against the white minority government of the former Southern Rhodesia. The Rhodesia case was the first real test for the Security Council to apply its strengthened international legal framework for economic sanctions. Implementation problems became apparent as the different legal systems of member states led to varying interpretations regarding how the sanctions would apply and be interpreted under domestic law. There were also problems regarding mutual assistance and overlapping jurisdiction between countries over the same parties and transactions, and there was great difficulty in persuading countries bordering Rhodesia, such as South Africa, to enforce the sanctions effectively. The effectiveness of the sanctions has been a subject of debate, as they were in effect for thirteen years before Ian Smith's government in 1979 finally conceded to hold multi-racial elections (House of Lords, 2007).

The problems of implementation and enforcement continued to plague Security Council sanctions programmes well into the 1990s. In the first Iraq War in 1990 (or 'the Kuwait War'), there were problems in the war's early stages in coordinating the application of sanctions against Iraq and Iraqi-occupied Kuwait. Following the US government's imposition of sanctions against Iraq and Kuwait after the Iraqi invasion,³⁷ the Security Council adopted Resolution 661³⁸ on 6 August 1990 which called on all states to freeze the assets of Iraq and Kuwait 'located within their territory.' Resolution 661 called upon all states to 'take appropriate measures

³⁵ Art. 41, UN Charter.

³⁶ Art. 42, UN Charter.

³⁷ The US had three main objectives in freezing Kuwaiti assets: (1) to protect the assets from the invaders in order to 'prevent the misappropriation of the assets'. This made it impossible for the Iraqi government to have access to over \$200 million of blocked Kuwaiti assets abroad; (2) to keep leverage over the Kuwaiti royal family against coming to an agreement with Saddam Hussein that would be contrary to US policy; and (3) to apply the frozen assets toward financing the war against Iraq.

³⁸ SC Res. 661 (6 Aug., 1990), 29 *ILM* 1325–1327 (1990).

to protect assets of the legitimate government of Kuwait and its agencies'.³⁹ The resolution also called for the imposition of trade sanctions against both Kuwait and Iraq, and provided an international legal basis for the freezing of Iraqi and Kuwaiti assets. The adoption of Resolution 661 was followed by the imposition of freeze orders and trade sanctions against Iraq and Kuwait by most European countries, the US, Japan, and Canada.

The difficulties of complementary and coherent implementation, however, were apparent by the different legal techniques used by countries. For instance, Canada imposed financial sanctions against Iraq and Kuwait on 3 August 1990, and then, following the adoption of Resolution 661, issued further orders pursuant to Canada's United Nations Act that froze Iraqi and Kuwaiti assets and imposed a trade embargo (Alerassol, 1993, 174–77). Canadian sanctions applied not only to Canadian citizens and businesses but also to the branches of Canadian companies operating in third countries. These sanctions, however, did not reach the foreign subsidiaries of Canadian companies. US sanctions had a broader coverage, applying not only to the foreign branches of US companies but also to their foreign subsidiaries and affiliates.⁴⁰ In contrast to both Canada and the US, Swiss, British, French, Japanese and EC sanctions regulations did not apply extra-territorially.⁴¹ Following the conclusion of the Kuwait War, these differences in legal and regulatory techniques contributed in part to poor co-ordination and enforcement of the various national sanctions programmes, notwithstanding the international legal basis for the adoption of such sanctions under Resolution 661.

The comprehensive UN sanctions that were imposed on Iraq in the 1990s raised a number of issues regarding their economic and social impact. Generally, the UN had had experience with two types of sanctions regimes: 1) comprehensive economic embargoes, 2) targeted or 'smart' sanctions – focusing on finance, travel, commodities and specific arms exports. The application of comprehensive economic sanctions had a tremendous effect on civilians and imposed substantial social and economic costs.⁴² The

³⁹ 29 *ILM* 1326.

⁴⁰ See Exec. Ord. 12722 (2 Aug. 1990); Exec. Ord. 12723 (2 Aug. 1990). These orders were reissued by the OFAC in regulations entitled: Iraqi Sanctions Regulations, 31 C.F.R. §575.100 *et seq.* On 30 July 2004, President Bush signed Executive Order 13350 that effectively lifts all economic sanctions against Iraq except for certain sanctions and blocking orders against designated Iraqi nationals and entities.

⁴¹ The Swiss Federal Council prohibited trade and financial transactions with Iraq and Kuwait. See Decree Instituting Economic Measures Towards the Republic of Iraq and the State of Kuwait (7 Aug. 1990).

⁴² The UN applied comprehensive economic sanctions against Iraq SC/Res/661 (6 Aug 1990) (1990–2003), Yugoslavia SC/Res/713 (25 Sept. 1991) (1991) and SC Res/757 (30 May 1992) (1992–95) SC/Res/1160 (31 Mar. 1998), Bosnia-Herzegovina SC/Res/820

broad impact of sanctions on the civilian population was viewed by some policymakers as not intended and this undermined their legitimacy and effectiveness. In the late 1990s, the Security Council approved the oil-for-food programme to alleviate the economic and social misery which the sanctions were creating for the Iraqi civilian population. Although the administration of the oil-for-food programme was severely criticized in the Volcker Report in 2003, it is generally accepted that the programme did accomplish its humanitarian objective of allowing much needed food, medicines and other necessities to reach the Iraqi people during the later stages of the sanctions period. The lessons learned from the Iraqi sanctions case was that sanctions need to be more targeted in areas such as border inspections and trade with contiguous states, dual-use military items, and financial controls.

During the 1990s, there was a general move towards the use of more targeted sanctions by the Security Council and major states that would apply financial and travel restrictions on government officials of targeted states and other individuals and business entities who provide commercial or financial support to these officials. Smart sanctions were also applied directly against non-state organizations and revolutionary groups and the commodities which they were selling to finance their violent activity. UN sanctions were imposed against the Angolan rebels led by Jonas Savimbi in 1993 (UNITA) (1993, 1997–98) because of their violent efforts to disrupt democratic reforms in Angola. Commodities were the subject of sanctions as well: diamonds sold by the UNITA rebels in Angola and by revolutionaries in Sierra Leone, along with timber in Liberia, were the target of sanctions which led to strict licensing processes for their sale and distribution, such as the Kimberly process for diamonds.

Moreover, the US practice of imposing smart sanctions against designated terrorists beginning in the early 1990s formed the basis of the targeted sanctions programmes that were later adopted against terrorists such as Bin Laden and Al Qaida (1999, 2000). These targeted sanctions aim to interdict resources for terrorists and terrorists organizations, and are not intended to have broad social and economic impact. The use of smart sanctions – mainly financial and travel restrictions and controls on strategic goods – has grown dramatically since the 1990s and has continued to this day. The global war on terror has dramatically transformed the nature and use of economic sanctions away from state-centred targets to non-state actors that include individuals, business entities, political organizations and the third parties who provide their support. This has resulted in the

(17 April 1993) (1993–95) (exception for arms for Muslim Bosnians), Somalia SC/Res/733 (23 Jan 1992), Haiti SC/Res/841 (16 June 1993) and SC/Res/917 (6 May 1994) (1993–1994).

most dramatic increase in the scope and application of international and national economic sanctions in modern history.

Conclusion

This chapter provides the historical background and context for the use of economic sanctions in the globalised economy of the twenty-first century. Since antiquity, nation states have utilized economic sanctions in a variety of ways to achieve economic and foreign policy and national security objectives. The design and scope of economic sanctions laws and regulations have varied depending on the objectives to be achieved. As globalisation facilitates the integration of international economic activity, states are increasingly relying on economic sanctions to accomplish an array of foreign policy objectives.

The chapter also discussed the purposes and the development of economic sanctions laws and regulations in recent years and highlights some of the main challenges confronting policymakers. The bilateral co-operation between the UK and US governments during the two world wars was mentioned as an example of how states can co-ordinate the application of their sanctions policies and utilize effective legal techniques to accomplish sanctions objectives. The failure of the member states of the League of Nations and the US to take the necessary measures to impose economic sanctions against aggressor states undermined the League's authority and ultimately failed to deter aggression.

Nevertheless, the League provided a valuable legacy on which was built the sanctions practice of the United Nations. Moreover, many states, including the United States, the United Kingdom and the European Communities have adopted unilateral economic sanctions against state and non-state actors to reaffirm international norms and national security interests. The twentieth century saw a vast increase in the number of international agreements and customs that seek to protect political, civil, and other human rights. The breach of these rights and norms today serve as justification for the imposition of economic sanctions. This has been demonstrated in a number of cases including the economic sanctions imposed in recent years by the European Union and the British government against Belarus, Burma and Zimbabwe. These sanctions initiatives have been taken at the national and EU levels independent of the United Nations.

The experience of the UN's sanctions regime has not been without its difficulties and failures: UN sanctions against Southern Rhodesia took 13 years to drive the white minority government from power, and sanctions against South Africa only became effective once the US imposed extra-territorial financial sanctions that severed South Africa's access to the US dollar and its financial system. In the 1990s, UN sanctions against Haiti and Iraq were overly broad in their impact on the economies of those countries and caused

much social damage and human misery. Essentially, the lessons learned from the Iraqi and Haiti sanctions episodes were that future sanctions regimes need to be narrowly focused on certain government officials and business elites and key sectors of the economy that affect state power and security, such as strategic military products and technologies, controls on bank accounts and other financial assets, and tighter border controls. The Security Council has slowly learned this lesson regarding the application of targeted sanctions against terrorists, but substantial weaknesses in regulation, implementation and enforcement remain at the national level and will be analysed further in this study.

2

International Political Economy and Economic Sanctions

[I]n foreign affairs, three alternatives alone are to be chosen from.

1. Embargo. 2. War. 3. Submission and Tribute

Thomas Jefferson (1806)

Introduction

The chapter generally examines the evolving structure of the modern international economic system and foreign exchange markets and some of the main economic theories which have driven its development and the implications for public policy regarding the application of economic sanctions. The chapter argues that the design of economic sanctions instruments has been influenced primarily by unrealistic political demands and inflexible legal doctrines which have undermined their effectiveness in state practice. Policymakers have failed to take adequately into account the relevant economic principles that drive the international financial and trading system. The chapter suggests that the comparative advantage of states in particular market sectors significantly enhances their ability to impose effective economic sanctions for those sectors. For instance, states with a relatively large share of the world's exports of investment capital and financial services should be much more effective in applying controls on these sectors than states with relatively undeveloped financial and investment markets. A state's utilization of economic sanctions in market sectors where it has a comparative advantage will enhance the efficacy of its sanctions programme and thereby be more likely to achieve public policy objectives.

The public policy objectives of economic sanctions – imposing economic costs, withholding benefits and sending clear signals to foreign targets and third countries – can only be achieved if the state imposing the sanctions can afford the opportunity costs of imposing them while inflicting significant costs on the target. This involves the sanctioning state having the capacity to withhold significant flows of goods, services and capital from its economy to the economy of the targeted state. Indeed, a country's ability to

control access to its wealth through economic controls and restrictions without undermining its own economic development can potentially promote a wide range of public policy objectives. Moreover, in an increasingly globalised economy, countries with large economies in terms of economic output and financial development have significant advantages over countries with smaller economies and less sophisticated financial systems in terms of their ability to use access to their markets and financial systems to promote public policy objectives. The chapter first examines the modern international economic system and reviews the literature regarding the effectiveness of sanctions. It will then analyse the main theories of international trade and comparative and competitive advantage to suggest an alternative model for how states should focus their economic sanctions programmes. The discussion then focuses on global foreign exchange markets and the level of exposure in different currencies by banks in different countries to suggest that the integration of global financial markets has made the world's economies dependent on a few reserve currencies for financial and trade transactions, and therefore suggests that the application of financial sanctions should be led by a group of leading financial powers acting together according to agreed principles and preferably through a multilateral institution.

I The modern international economic system

The modern global economic system has been governed since 1944 by the so-called Bretton Woods institutions (the IMF, World Bank and GATT/WTO). At Bretton Woods, New Hampshire in 1944, the leading industrialised states and market economies concluded multilateral treaties to rebuild the international economic order based on liberal economic principles. The two main treaties were respectively the Articles of Agreement that established the International Monetary Fund and the Articles of Agreement that established the World Bank (Newburg, 2000). The IMF Articles of Agreement permitted national authorities to impose and maintain controls on domestic financial systems through, for example, maintaining fixed exchange rates for the leading reserve currencies.¹ The lynch pin currency of the IMF fixed exchange rate system was the US dollar which was convertible into gold at a prescribed rate of \$35 an ounce and convertible into other reserve currencies at predetermined par values. Although the fixed exchange rate

¹ The Bretton Woods system allowed nations to impose an extensive system of foreign exchange and capital controls throughout the 1940s and 1950s. Currency convertibility and capital controls began to be dismantled in the 1960s and were officially eliminated in 1972 and 1973 when President Nixon terminated the convertibility of US dollars into gold at a fixed exchange rate and ended fixed exchange controls between currencies.

regime brought financial stability by substantially reducing foreign exchange risk and eliminated the incentive for states to pursue beggar thy neighbour trade policies, it also resulted in the build-up of macroeconomic imbalances among the major trading states. These imbalances were exacerbated by the IMF fixed exchange regime and provided the impetus for the US to close the gold window and withdraw unilaterally from the treaty-mandated IMF currency regime in 1971. This began a series of events that led other major reserve currency countries to float their currencies against the US dollar and eventually to a consensus view that a liberalized international financial system was a worthwhile policy objective to promote economic growth and development.²

In international trade, the establishment of the Bretton Woods system provided the negotiating forum that led to the adoption of the General Agreement on Tariffs and Trade (the 'GATT'), which provided the foundation principles for building a new free trade order (Finlayson and Zacher, 1983). The GATT international trade regime reflected not only the idealistic conception of a liberal trade order, but also the cold calculation that such an order would serve and promote the political and economic interests of the world's leading capitalist superpower and its allies (Ikenberry, 1992, 291–293).³ The political value of establishing a liberal trading order rested on the assumption that liberalized markets would promote economic prosperity and political stability which would provide a bulwark against the spread of communism in Europe and in the developing world. Similarly, liberalized markets and economic prosperity were expected to produce fertile overseas markets for the US and other industrialized country exporters.

During this period, tariff barriers on cross-border trade in goods were gradually reduced and restrictions on foreign exchange trading and cross-border financial flows were lifted. Consequently, a global trading system has emerged based on free trade principles that are enshrined in today's World Trade Organisation agreements along with the development of a global market in monetary and financial instruments. These structural changes to the global economy have resulted in increased interaction and dependence of states on international trade and finance. Because of increased economic and financial interdependence among states, states are more vulnerable to changes in the economic and financial policies of other states,

² The reference to liberalized markets means reduced barriers to trade in goods and later, following the collapse of the Bretton Woods system, financial services.

³ Ikenberry (*ibid*) argues that post-war economic diplomacy was crafted based on a consensus between American and British policy experts who espoused the basic principles of Keynesian economics to establish durable post-war international economic institutions which had a primary focus on achieving international monetary stability which would provide the basis for achieving a liberal global trading order.

especially to states with large markets and sophisticated financial systems that use reserve currencies (e.g. US dollar and euro) which other states need to conduct successful international trade and financial policies. Such countries that exercise substantial influence in the global economic and financial system are systemically important and are well-positioned to use their economic influence to promote foreign policy and other non-economic policy objectives.

In the last half of the twentieth century, the leading industrial states began to transform their economic systems by promoting policies that led to deregulation and privatization in many industries and increased liberalization in international trade and in the provision of financial services. These changes were greatly facilitated by advances in technology and in a growing consensus that markets were the most appropriate and optimal mechanism for allocating economic resources. In global financial markets, growing cross-border capital flows have been an important source of liquidity and investment for developed and developing countries, but have also been responsible in certain circumstances for the cross-border transmission of banking and financial crises (Eatwell and Taylor, 2000) (Kenen, 2001, 20–27). Nevertheless, these economic and financial linkages continue to grow and have led to unprecedented interdependence in the global financial system (Stiglitz, 2002). As a result, a global economic and financial system has emerged that appears to be evolving inexorably towards greater integration and mutual dependence between most domestic economies.

The increased integration of the global economy and the development of sophisticated financial systems dominated by financial institutions of the world's richest states and the continued predominance of a few reserve currencies in foreign exchange transactions have effectively resulted in the major G10 countries controlling and influencing most aspects of international economic and financial policy and regulation.⁴ Some of these countries, such as the United States, have used access to their large economies and financial systems as an instrument of foreign policy and national security.

Before examining the size and scope of the economies and foreign exchange markets of some leading countries, it is necessary to review the literature that measures the effectiveness of economic sanctions in imposing costs on their targets.

⁴ The G10 countries are the world's richest industrialized economies measured by per capita income and the value of their financial transactions: they include Austria, Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Switzerland, United Kingdom, and the United States.

II A review of the empirical evidence on economic sanctions

The most important study to measure the effectiveness of economic sanctions was conducted by Hufbauer, Schott, and Elliot (1985) (1990a; 1990b) which examined 116 major cases of sanctions extending back to the First World War when the UK imposed a trade embargo and asset blocking orders against Germany (Hufbauer *et al.*, 1990b). The last of their case studies was the US sanctions imposed in 1989 against the Sudanese government for its persecution of certain religious and tribal groups (Ibid., 632–635). To assess the effectiveness of a particular sanctions regime, they constructed an index system that listed a set of officially stated policy goals for each sanctions measure, and a numerical scale between ‘1’ and ‘4’ to show whether these policy goals had in fact been achieved by a particular sanctions measure (Hufbauer *et al.*, 1990a, 42).⁵ To do this, they used a discrete four-point scale to show whether the objective had been achieved or not. On a scale between ‘1’ and ‘4’, ‘4’ was the highest score suggesting the sanctions measure was successful, while ‘1’ was the lowest score suggesting the sanctions measure was unsuccessful (Ibid., 56–62). They then used another variable, also between ‘1’ and ‘4’, to show the extent to which each sanctions measure – i.e. a statute or regulation – contributes to achieving the objectives of the sanctions. To determine the overall effectiveness of a sanctions measure, they then scaled both numbers to show an overall measure of sanctions effectiveness (Ibid., 42). The authors decided that a score of ‘9’ or higher was a success.

The model worked as follows. The authors would assess whether a country that has imposed economic sanctions against a targeted state or person had in fact achieved one of the four policy goals. For instance, once sanctions were imposed, did they result in a destabilisation of the target government? Or did they result in a disruption of a military adventure, or some other major policy change by the target government? such as a decision to pay compensation to expropriated foreign property owners (Ibid., 38). If the authors determined that a sanctions’ policy goal or objective had been fully achieved, they would score a ‘4’ in the policy goal category. While in the other category, they decided on a scale of ‘1’ to ‘4’ the role that the sanctions measure played in achieving the policy objective. They then multiplied these two numbers to achieve an overall rating of the effectiveness of a state’s sanctions measure. For example, a ‘3’ score in achieving a sanctions objective would be multiplied by a ‘4’ if the sanctions measure had played a

⁵ The objective ‘policy goals’ were divided into five categories: (1) modest changes in policy, (2) destabilizing a government, (3) disrupting military adventures, (4) impairing military potential, (5) other major policy changes (Hufbauer *et al.*, 1990a, 49–55).

large role in achieving the objective for a total score of '12'. The '12' score exceeded '9', thus indicating that the sanctions measure had been a success.

Hufbauer *et al.* applied their model to 115 episodes of economic sanctions between 1914 and 1990 and concluded that in only 34 per cent of the cases did the sanctions measures achieve one of the four policy objectives (Ibid, 1990a, 91–93). This seminal work attracted much academic and policy-making attention, and several studies debated the merits of their methodology in measuring the effectiveness of sanctions. Pape (1997) called into question whether the 40 cases of sanctions that were defined by Hufbauer *et al.* as successful were in fact successful. Pape adopted a different methodology to show that only five of those 40 episodes of sanctions were successful. He argues that the remaining 35 episodes of sanctions deemed successful by Hufbauer suffered from measurement errors that did not take into account other factors that were equally responsible for achieving the sanctions' objectives. For instance, in 18 of those cases, military force played a role in achieving the objectives, and in eight cases the target state did not concede to the sanctioning state's demands, while six cases involved trade sanctions (not economic sanctions). Pape essentially argues that Hufbauer *et al.* overestimate the effectiveness of sanctions in their sample.

Baldwin (1998), however, criticized the Pape methodology as 'binary' because it focused too narrowly on whether a sanction measure is either a success or failure, whereas Hufbauer *et al.* provided a richer methodology that utilizes a four-point scale to measure success or failure over five different policy objectives. Subsequent studies conducted by Cortright and Lopez (2000) examined 14 sanctions cases between 1990 and 1999 by using a similar methodology as Hufbauer *et al.* They concluded that comprehensive sanctions were partially successful in three out of four cases, while targeted sanctions were much less successful, achieving their objectives in only two out of ten cases. Again, however, these studies suffer from the same methodological flaws in evaluating sanctions by focusing too narrowly on whether sanctions achieve their stated objectives. These studies do not take into account that sanctions can still be effective, even if they do not achieve their stated objectives, by performing other functions, such as signalling disapproval to target states or communicating support to domestic opposition groups within the target country, or warning other third country states not to engage in certain conduct with the target. Moreover, sanctions can also serve a retributive function by imposing costs on the targeted state without achieving stated objectives, and they can lead to costs being imposed on third country states that do not adhere to the sanctioning state's measures. The measure of the effectiveness of economic sanctions therefore should not necessarily be assessed in terms of whether they achieve their stated objectives, which may be only aspirational, but rather should be assessed in terms of whether they perform other functions, such as communicating to other

states and to supportive and opposing groups, or merely imposing economic costs on the targets in retribution for particular acts or policies.

III The theory of comparative advantage and economic sanctions

Before examining the size and scope of some of the world's advanced economies, it is necessary to review the main economic theories that drive international trade. State interests in pursuing international trade provide the context for understanding how a state's economic sanctions regime can be enhanced to impose economic costs on the target. An important assumption in the underlying analysis is that power and wealth are proper and harmonious goals of national policy; that nation-states pursue national interests defined in terms of power and wealth. In this context, there are basically two traditions which have sought to explain how power and wealth in the context of foreign economic policy can best be promoted in an integrated global economy: Protectionism and Liberalism. The Protectionist tradition in the United States can be traced back to 1791 when Alexander Hamilton presented his *Report on the Subject of Manufactures* to the US House of Representatives, introducing the idea of import substitution as a strategy for economic development (Hamilton, 1982, 232–236). Hamilton argued that in addition to wealth, power was determined by independence and economic security and it was in a nation's self-interest to endeavour to attain autarky and comparative advantage through what are now called 'industrial policies'. He believed that national power and wealth could be increased by protecting certain 'infant industries', which could not survive the rigours of international competition (Ibid.). Hamilton's ideas were taken up later by the German political economist Friedrich List during the nineteenth century who rejected British ideas of open trade on the Continent and, instead, called for protectionism in Germany to promote domestic industrial development. In his *National System of Political Economy* (1841), List argued that less-developed states ought to pursue protectionist policies in order to enhance their relative positions of wealth and power in the international system (List, 1841). He believed that Great Britain's free trade policies at the time were predatory policies of the strong aimed at gaining unimpeded access to foreign markets, particularly to the German states, to advance Britain's own economic position. Like Hamilton, he advocated high tariffs on certain infant industries at home, while exploiting the open markets and free trade policies of Britain abroad. List's ideas won him widespread support in Germany as industrial policies were developed under Bismarck to facilitate Germany's rise to power during the late-nineteenth century. These early mercantilist views espoused by Hamilton and List have served as the intellectual bedrock for protectionist tariff

policies amongst states, particularly less-developed countries, in contemporary international economic relations.

The other tradition in international political economy, which has emerged to dominate much of the political and economic dialogue in Anglo-American policy circles over the last two centuries, is the liberal tradition. The roots of economic liberalism can be found in Adam Smith's famous work *The Wealth of Nations*, which has been hailed for over two centuries as one of the most important achievements in international economic relations (Smith, 1937). According to Smith, aggregate power and wealth amongst states is best achieved if economic adjustments are left to market forces rather than mercantilist policies. He advocated a territorial division of labour based on absolute, or competitive, advantage in which nations specialise in what they produce best to be exchanged for other desired goods in an open market. The expansion of markets, he wrote, allows new specialisation to be introduced, which raises national as well as aggregate income by reducing the resource costs of production involved in old activities. Thus, in the same liberal tradition espoused by John Locke and embedded in the Anglo-American worldview that the free flow of ideas will produce sound political policies, Smith believed that free trade and open competition in the marketplace would produce the best quality goods at the most competitive prices for all people.

Two later studies expanded upon Smith's views. According to David Ricardo, in his *Principles of Political Economy and Taxation*, what is important is not the absolute cost of the goods produced but the relative cost (Ricardo [1817], 1871). In presenting his law of comparative advantage, Ricardo argued that countries would gain more by specialising in the production of those goods in which their comparative costs were lowest, even if one nation has an absolute advantage over others in the production of every good. Through specialisation and the international division of labour, free trade would increase economic efficiency and productivity which in turn would lead to the accumulation of national and global wealth. Moreover, the removal of trade barriers by a number of countries would increase economic efficiency on a broad scale by promoting a transfer of economic resources from less efficient to more efficient production and employment (Ethier, 1983, 23–25).

The Heckscher-Ohlin theory of international trade expanded upon Ricardo's law of comparative advantage by introducing the feature of resource endowments (capital and labour) which varied from country to country (Ibid., 98–103).⁶ According to the theory, the types of goods a

⁶ It is important to note that the Heckscher-Ohlin approach which has been dominant in orthodox theories of international trade takes technology as being uniformly available across countries. There is therefore no distinctive 'technology factor' in trade under this approach (Krugman & Obstfeld, 2003, pp. 68–70).

country will export depends on the relative factor endowment that each country possesses. For example, a capital rich country will specialise in capital-intensive (or value-added) products such as semiconductors or electronics and export them in exchange for relatively labour intensive commodities such as textiles or furniture, thereby increasing overall welfare. In each theory, international trade is conceived as a zero sum game, but is based on a harmony of interests founded on specialization and comparative advantage.

This notion of the harmony of interests based on comparative advantage is at the core of the liberal tradition in international economic relations and can provide a framework in assisting states in designing their economic sanctions instruments.

The theory of comparative advantage based on resource endowments can provide states with a model to decide what sectors of their economies should be utilized in their economic sanctions programmes. The application of sanctions can be costly not only for the target state but also for the sanctioning state in terms of lost exports and foreign investment and the costs of developing and complying with the sanctions. Some states, however, can afford the costs of imposing sanctions far better than others. Since the mid-twentieth century, the states with the largest and wealthiest economies have imposed economic sanctions on many more occasions than states with poorer and smaller economies, partly because the states with larger and richer economies can afford the opportunity costs of imposing sanctions and can more efficiently calibrate their sanctions to impose significant costs on the targets. In contrast, the opportunity costs for states with poorer and smaller economies, and without sophisticated regulatory controls or a comparative advantage in strategic industries, are much higher. This disadvantage becomes apparent when these states are required by international bodies to adopt elaborate and intensive sanctions measures that would create a disproportionately large cost for certain strategic, but less-developed, sectors of their economies for which they do not have a comparative advantage.

The theory of comparative advantage can be used as a model to guide the development of national economic sanctions instruments and to assist countries in coordinating the application of economic sanctions on a cross-border basis. For instance, countries could devise a number of cross-border strategies to impose sanctions by focusing their economic restrictions on particular export sectors of their economies where they provide a relatively higher portion of the exports in goods or services than other sectors of their economy. The effectiveness of this approach is measured by the relatively high costs it would likely impose on the target state or non-state actor. The coordination of this approach at the multi-lateral level would reduce the ability of the target to import from another third country to offset the sanctioning state's export restriction. States could form colleges of sanctions regulators who would have responsibility over particular industry sectors

and would coordinate on a cross-border basis with respect to those sectors. Great emphasis would be placed on inter-state coordination with only minimal political oversight by the UN sanctions committees. In a multi-polar global economic system, leading states with comparative advantages in strategic market sectors – ie., financial services or strategic technologies – should be encouraged to coordinate the application of their national sanctions controls to enhance their effectiveness on a cross-border basis. Indeed, in the aftermath of the 11th September 2001, the US has exploited its comparative advantage in the provision of financial services and investment capital to impose controls and restrictions on cross-border trade in financial services and on the US dollar as a reserve currency to sanction certain states and non-state targets and their supporters.

To ensure more effectiveness and equity in sanctions application, policy-makers should craft sanctions instruments – eg., export controls, asset freezes and other restrictive measures – which focus mainly on restricting access to the sectors of their economies where they have the greater advantage in output capacity *vis-à-vis* other sanctioning states and with respect to the target state. Comparative advantage, however, cannot serve as an exclusive theory for sanctions design. It must be complemented by other economic factors, such as the geographic proximity of the sanctioning state to the target state. Other factors will be relevant as well. Although the sanctioning state may have a comparative advantage in certain sectors of its economy, it should not neglect devising other sanctions instruments for economic sectors that produce less relative wealth but which may impact a militarily or economically strategic sector of the target state. A serious weakness in multi-lateral sanctions regimes is that they ordinarily require states to take the same restrictive measures towards the target without an assessment of the marginal costs which particular sanctions instruments will create for the sanctioning state – for instance, in terms of lost trade or tax receipts.

The marginal costs are high for developing countries and states with less advanced economies; they have relatively higher opportunity costs and compliance costs for most sectors of their economies than wealthier more advanced economies. Indeed, wealthy states have the luxury of affording the cost of imposing economic sanctions, whereas less-developed states incur much higher relative opportunity costs and regulatory implementation costs. Although the UN has recognized the importance of providing assistance to countries which have suffered substantial collateral damage as a result of UN sanctions programmes, more work should be done to analyse how sanctions can be applied differently between states. Perhaps, a type of variable geometry of sanctions practice could be constructed based in part on a state's comparative advantage in particular market sectors. A framework which relies on differential application of sanctions through the use of variable controls in different countries depending on their economic

capacities and the potential impact on the target could enhance the effectiveness of sanctions while achieving more equity between states in their application.

To understand the scope and extent of economic sanctions generally, it is necessary to review some of the linkages of the international economic and financial system and related economic data to demonstrate the influence exerted by the US and other wealthy industrial countries when they restrict access to their economies and capital markets. It is suggested that these countries with their large economies and extensive financial markets have a comparative advantage in certain key economic sectors (eg., financial services) which allows them to exert hegemonic influence in the global economy in order to achieve economic and non-economic objectives. Growing linkages in foreign exchange markets allow these countries to exercise considerable regulatory influence over other states and nationals who use their currencies.

IV International financial markets and economic sanctions

Rather than supplement or reject the theory of comparative advantage, this study uses key portions of the theory to explain the growing use by advanced developed countries in the post-9/11 era of financial sanctions to target state and non-state actors – including terrorists, terrorist organizations and their business supporters. The most influential economies and financial systems are controlled and regulated by the G10 advanced industrialized countries and by European economic institutions, especially the European Central Bank. Within the G10, the position of the United States is critical because of its leading role in the global economy and financial markets, and its ability to make access to its huge markets contingent on complying with its sanctions regulations. Since the end of World War II, Chart 1 shows that US gross domestic product as a percentage of world GDP has remained the largest of any single national economy in the world. Although the US share of world GDP has dropped slightly from approximately 35 per cent of world GDP in 1960 to just over 31 per cent in 2005, it remains by far the largest national economy in the world. The relative openness and size of the US economy in terms of international trade, direct investment and financial transactions compared to most other countries, suggests that a carefully designed trade and financial policy could impose significant costs on US trading partners by denying them access to US exports and imports and restricting their access to US capital. These could be effective levers that could be deployed as part of a broader economic sanctions policy.

Other major developed G10 countries have experienced different rates of GDP growth as a percentage of the global economy. For example, Japan accounted for less than ten percent of the world's GDP in 1960, but its economy grew substantially in the 1980s and by 1991 accounted for over

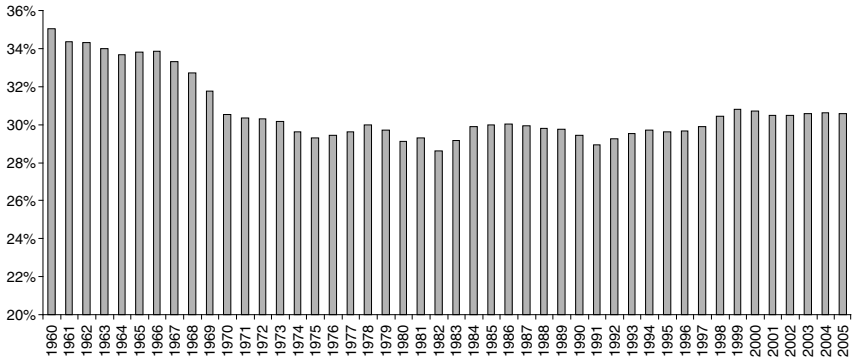


Chart 1 US GDP as % World GDP, 1960–2005

Source: The World Bank's World Development Indicators.

18 per cent of world GDP. Japan's share of world GDP, however, dropped dramatically in the 1990s primarily because of its economic recession brought on by the collapse in value of its equity markets, and the severe retrenchment in its banking sector, which led to the so-called 'lost decade'. In 2005, Japan's share of world GDP had stabilized at about 14 per cent of world GDP. Furthermore, Japan plays a major role in trade and investment with the Asian Pacific region and its currency the yen is the third largest currency used in the world's foreign exchange markets. In recent years, Japan has become more assertive in using economic and financial sanctions against states such as North Korea and Iran and against designated terrorist groups (Miyamoto, 2006).

In contrast, since the 1960s the British economy has grown at a slower pace than Japan's. In 1960, Britain's economy constituted 7.5 per cent of world GDP, but the cumulative effect of several severe recessions in the 1960s through the early 1990s along with relatively low levels of productivity and output compared to the other wealthy European countries contributed to a significant drop in the UK's economic growth rate relative to other developed countries. During this period, Britain's GDP as a percentage of world GDP dropped substantially from over 7 per cent of world GDP in 1960 to just over 4 per cent in 2005. As discussed in chapter 4, Britain infrequently used economic sanctions in the 1960s through 1980s and in the few cases where sanctions were imposed, such as against the former Southern Rhodesia and South Africa in the 1980s, it did so only with countries with whom it had strong trade and investment relationships and cultural ties. Although Britain's share of world GDP has dropped significantly over the least thirty years, it began to increase its use of targeted economic sanctions

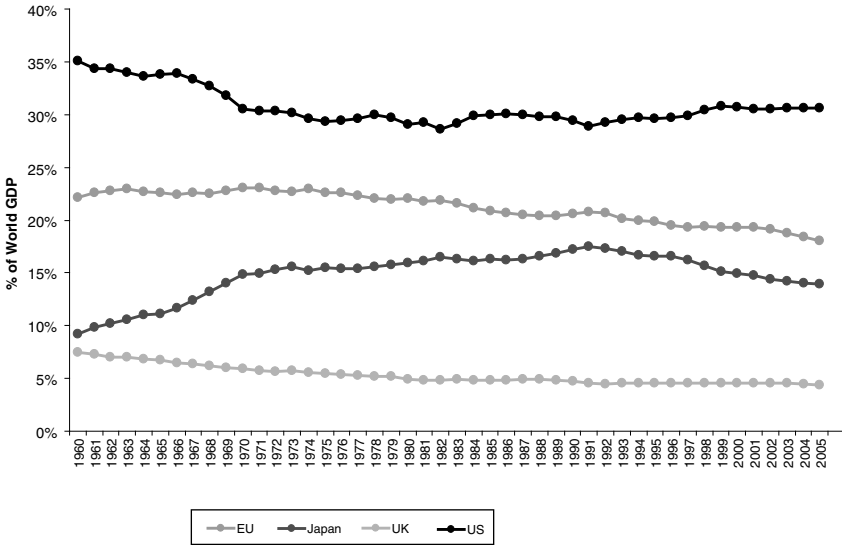


Chart 2 Country GDP as % World GDP, 1960–2005

Source: The World Bank's World Development Indicators.

in the late 1980s and early 1990s against countries with poor human rights records such as Burma and against countries whom the international community had condemned, such as the former Yugoslavia, and certain African countries involved in diamond and lumber trafficking such as Angola, Sierra Leone and Liberia. During this period, London's role as an international financial centre has grown dramatically and the UK has not been reluctant to take advantage of its financial status to put economic pressure on other states to comply with broader foreign policy objectives. To this end, the UK has established a comprehensive financial regulatory framework to combat financial crime and has substantially reformed its export control law to improve controls of exports to targeted countries and individuals.⁷ Nevertheless, the use of financial sanctions by the UK has been constrained by its concern that it might lose a significant portion of its financial services business if sanctions are applied in too onerous a manner. In 2008, the UK Treasury blocked the accounts and forced into administration the London branch of the Icelandic bank Landsbanki and blocked the UK bank accounts of another Icelandic bank Kaupthing in response to these Icelandic banks defaulting on their deposit insurance obligations to UK account holders. These financial sanctions suggest that the UK will be more proactive in the future using sanctions to support its financial policy.

⁷ See Export Control Act 2002 (discussed in chapter 4).

The original countries of the eurozone have generally experienced (12 EU countries adopted the euro as their single currency in 1999)⁸ stable rates of economic growth since the early 1960s, but their share of world GDP has fallen from a high of just over 23 per cent in 1974 to just over 17 per cent in 2005. Although these eurozone states constitute a lower share of world GDP today than they did in the 1960s and 1970s, the transformation of the European Economic Community⁹ to the European Union in the 1990s was accompanied by an increase in Community powers in the area of foreign and security policy which has resulted in an increase in the use of economic sanctions against targeted states and individuals allegedly involved in terrorism or human rights violations. Indeed, the growing use of Community sanctions under the EU's autonomous sanctions programme has been a growing source of concern for some policymakers and lawyers advising businesses and suggests that the EU will play a more proactive role in using economic sanctions (House of Lords, 2007, 12).

In financial markets, the United States continues to dominate the world's banking and capital markets. US capital markets remain the most liquid in the world and the most open to foreign investors. In 2006, net foreign purchases of US issued securities were \$78 billion, a reduction from 2005 when there were \$97.4 billion (Bloomberg, 2006). Despite the drop in foreign investment in US securities, the US economy remains by far the most substantial economy in the world, comprising 32 per cent of the world's GDP.¹⁰ Moreover, the dominance of the US dollar as a reserve currency in the international banking sector is demonstrated in Table 2.1. Table 2.1 shows the percentage of cross-border assets denominated in US dollars as a proportion of cross-border assets denominated in other currencies. It does so by comparing the percentage of cross-border assets held by lenders in four major economic regions of the world – the euro area, other developed countries, offshore centres and some major developing countries – to banks/debtors in a sample of countries that reported to the Bank for International Settlements (BIS).¹¹

Table 2.1 provides evidence of the dominant status of the US dollar in the world's foreign exchange markets with respect to cross-border claims of

⁸ The countries of the EMU are: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, and Spain. In 2008, the euro-zone has fifteen members, including Northern Cyprus, Slovenia and Malta.

⁹ The EEC was established by the Treaty of Rome in 1957: its original members included Germany, France, Italy, Luxembourg, Belgium, and the Netherlands.

¹⁰ World Bank economic growth index.

¹¹ All cross-border claims in Table 2.1 are denominated in thousands of millions of US dollars. The data on total cross-border assets denominated in US dollars is presented in percentages of total cross-border assets held by banks/lenders in four major economic regions. The raw data that supports these percentage calculations is restricted from being publicly disclosed by BIS rules.

Table 2.1 Total cross-border assets of banks in USD and all currencies as of Q4 2005^a

Claims of banks in the BIS reporting countries in					
Claims on	Claims of banks in the BIS reporting countries in				
	Euro area	Other developed countries	Offshore centres	Developing countries	Total
	USD as % of all currencies	USD as % of all currencies	USD as % of all currencies	USD as % of all currencies	USD as % of all currencies
Angola	73%	100%	100%	0%	87%
Argentina	62%	80%	99%	78%	76%
Australia	19%	26%	89%	43%	29%
Austria	6%	27%	30%	57%	12%
Belgium	13%	27%	69%	73%	19%
Cayman Islands	53%	78%	99%	94%	76%
Cuba	45%	11%	100%	93%	52%
Czech Republic	4%	69%	89%	11%	18%
Egypt	38%	53%	0%	27%	45%
France	6%	30%	70%	48%	22%
Germany	7%	17%	37%	30%	12%
Hong Kong sar	47%	57%	54%	52%	54%
Iran	42%	62%	68%	67%	50%
Japan	10%	46%	43%	23%	34%
Luxembourg	10%	43%	49%	77%	26%
Mexico	44%	90%	96%	57%	77%
Netherlands	9%	28%	36%	48%	19%
North Korea	64%	22%	-	-	58%
Philippines	61%	62%	99%	82%	63%
Russia	79%	86%	98%	84%	82%
Saudi Arabia	63%	71%	60%	50%	68%
Singapore	61%	35%	64%	73%	46%
South Africa	42%	32%	55%	49%	36%
South Korea	56%	72%	95%	72%	69%
Switzerland	18%	63%	45%	58%	48%
Turkey	49%	57%	77%	54%	52%
Uk Excl. Islands	18%	63%	45%	56%	37%
Ukraine	73%	70%	100%	40%	71%
Venezuela	56%	89%	99%	81%	81%

Notes: ^a 1) Amounts outstanding in millions of US dollars. 2) Covers data of reporting countries which provide currency breakdown of their positions vis-à-vis individual countries. 3) Euro area reporting countries: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain. 4) Other developed reporting countries: Denmark, Norway, Sweden, Switzerland, UK, Australia, Canada, Japan and US. 5) Offshore centre reporting countries: Bahamas, Bermuda, Cayman Islands, Guernsey, Isle of Man, Jersey and Panama. 6) Developing reporting countries: Brazil, Chile, India, Mexico, Taiwan-China, Turkey and South Korea.

Source: BIS international locational banking statistics by residence.

banks outside the US. The data provide a currency breakdown of the position of banks in four different reporting zones regarding their cross-border claims against banks/debtors in the respective reporting countries.¹² For example, in the first row, the data show that banks in the euro area have 18 per cent of their cross-border claims against UK-based banks/debtors denominated in US dollars. Banks in other developed countries¹³ have 63 per cent of their cross-border claims against UK banks/debtors denominated in US dollars. Banks in offshore centres have 45 per cent of their cross-border claims against UK-based banks/debtors denominated in US dollars. And banks in developing countries¹⁴ have 56 per cent of their cross-border claims against UK-based banks/debtors denominated in US dollars. This relatively high level of US dollar exposure by UK banks to cross-border lenders is not unusual given London's traditional role as an international financial centre and provider of euro dollar transactions. Moreover, as discussed in Chapter 10, the high percentage of US dollar exposures by UK-based banks exposes them to potential US regulatory action regarding anti-money-laundering and terrorist financing requirements.

Similarly, banks based in Venezuela, an oil-rich developing country which has had a number of political disputes with the US in recent years, have an even greater exposure in US dollars to cross-border lenders. Table 2.1 shows that euro area lenders have 56 per cent of their cross-border claims against Venezuelan banks/debtors denominated in US dollars, while other developed country lenders have 89 per cent of their cross-border claims denominated in US dollars, offshore centres have 99 per cent of their cross-border claims denominated in US dollars, and developing country lenders have 81 per cent of their cross-border claims denominated in US dollars. Total cross-border claims in US dollars against Venezuelan banks/debtors amount to 81 per cent of all cross-border lending claims against Venezuelan entities. The high proportion of these cross-border bank claims in US dollars exposes the Venezuelan banking system to substantial regulatory risks if the US were to impose economic or financial sanctions against the US dollar assets and transactions of Venezuela and Venezuelan businesses. Nevertheless, Venezuela's position as a major oil exporter to the US militates against the US imposing sanctions that might jeopardise the availability of US oil imports.

Regarding the Cayman Islands, an important offshore jurisdiction, the US has launched in recent years a number of money laundering, tax and terrorist financing investigations involving Cayman financial intermediaries.

¹² The four different reporting zones were the 1) euro area, 2) developed countries outside the eurozone, 3) offshore jurisdictions, and 4) certain developing countries.

¹³ 'Other developed countries' are defined as Denmark, Norway, Sweden, Switzerland, UK, Australia, Canada, Japan, and the US.

¹⁴ Brazil, Chile, India, Mexico, Taiwan-China, Turkey and South Korea.

Although a British dependency, Cayman has a high proportion of its cross-border bank exposures denominated in US dollars. Table 2.1 shows that euro area lenders have 53 per cent of the value of their cross-border claims against Cayman banks/debtors denominated in US dollars, while banks in other developed countries have 78 per cent of the value of their cross-border claims against Cayman banks/debtors denominated in US dollars; banks in developing countries have 94 per cent of the value of their cross-border claims denominated in US dollars. This high proportion of US dollar liabilities held by Cayman entities has attracted the scrutiny of US regulators and tax authorities in investigations involving alleged money laundering, securities fraud and tax evasion. Indeed, the ability of US authorities to freeze or block dollar accounts maintained by Cayman banks explains partially why the Cayman Islands has relented in certain situations to extra-territorial US requests for information and in some cases has recognised US blocking orders.¹⁵

Another jurisdiction that has come under pressure from the US is Switzerland, a major banking and financial jurisdiction. The US has been particularly aggressive in trying to obtain Swiss co-operation in blocking euro dollar accounts held by Swiss banks that may, according to US authorities, be involved in money-laundering and financing terrorism and the development of weapons of mass destruction. Table 2.1 shows that the Swiss banking system is vulnerable to US financial pressure, as cross-border lenders have 48 per cent of the value of their cross-border claims against Swiss banks denominated in US dollars. This high percentage of US dollar claims explains in part why two of Switzerland's largest banks – Credit Suisse and UBS – agreed in 2006 to cease financing trade or performing financial transactions with Iran, Cuba and North Korea and their nationals and business entities.¹⁶ As discussed in later chapters, the heavy reliance by the banking sectors of these countries on US dollar liabilities and assets subjects them to substantial US economic and political pressure to recognise and implement some of the main requirements of US economic and financial sanctions regulations.

Similarly, Japan is another country subject to heavy US financial pressure to restrict economic engagement with US targeted states and persons. For all cross-border lenders, 34 per cent of the value of their cross-border claims against Japanese banks are denominated in US dollars. 46 per cent of the value of claims of non-euro area developed country lenders to Japanese

¹⁵ See *In re Grand Jury Proceedings, United States v. Bank of Nova Scotia*, 691 F. 2d 1384 (11th Cir. 1982); and *In re Grand Jury Proceedings, United States v. Bank of Nova Scotia (Bank of Nova Scotia II)*, 740 F. 2d 817 (11th Cir. 1984) (summarized in chapter 3).

¹⁶ 'US Bid to Limit Iran Gets Wary Response' *Wall Street Journal* online Neil King, A4 (Dec. 29, 2006).

banks are denominated in US dollars. The high percentage of US dollar exposures of Japanese-based banks explains a great deal why Japanese banks have restricted their business practices with US-targeted states such as Cuba and Iran. As discussed in Chapter 4, Japan has adopted their own unilateral economic sanctions programmes against North Korea and international terrorists. The main point, however, is that Japan's high level of economic and financial interaction with the United States and dependence on cross border lending in US dollars has subjected it to tremendous US economic and political influence, especially regarding the application of US sanctions.

Table 2.2 below provides aggregate totals of cross-border currency exposures divided into assets and liabilities based on the reports of banking and financial institutions in 36 countries that comprise the world's most sophisticated financial systems.¹⁷ In the upper category, the aggregate composition of domestic currencies for cross-border bank lending is provided. Cross-border assets (e.g. lending) in euros held by banks which had the euro as their domestic currency had a value of \$5,277.7 (US) billions in September 2005, far exceeding the value of \$1,862.0 (US) billions in cross-border assets in US dollars held by banks which had the US dollar as their domestic currency. The dominance of the euro in this category can be explained mainly by the much larger total size of the euro-zone economy compared to the US economy and the relatively high number of countries in the euro-zone (13 in this data sample) where cross-border loans in euros could be made, as opposed to the US which is counted as a single country.

The next category entitled *foreign currency* contains the aggregate composition of the cross-border bank exposures in foreign exchange markets. In the column for September 2005, the data show that the US dollar is by far the leading currency held as a foreign exchange asset with a value of \$6,568.1 billions, as compared to the euro which made up a much lower absolute value of foreign exchange assets of \$2,520.2 billions. As the column for December 2003 indicates, the aggregate holdings of US dollars in the foreign exchange markets increased from \$5,042.8 to \$6,568.1 billions, an increase of \$1,525.3 or 23 per cent, while euro holdings in the foreign exchange markets increased from \$2,020.2 in 2003 to \$2,520.2 in 2005, an increase of \$500 billions or nearly 20 per cent. In 2005, UK sterling was the third highest in foreign exchange assets at \$567.5 billions, while the Japanese

¹⁷ The jurisdictions are: Australia, Austria, Bahamas, Bahrain, Belgium, Bermuda, Brazil, Canada, Cayman Islands, Chile, Denmark, Finland, France, Germany, Guernsey, Hong Kong, India, Ireland, Isle of Man, Italy, Japan, Jersey, Luxembourg, Netherlands, Netherlands Antilles, Norway, Panama, Portugal, Singapore, Spain, Sweden, Switzerland, Taiwan, turkey, United Kingdom, United States.

Table 2.2 Currency breakdown of reporting banks' cross-border positions (in billions of US dollars) vis-à-vis all sectors

Currencies	Amounts outstanding					Estimated exchange rate adjusted changes						
	2003	2004	2005	2005	2005	2003	2004	2004	2005	2005	2005	2005
	Dec.	Dec.	Dec.	Sept.	Year	Year	Year	Q4	Q1	Q2	Q3	Q3
Assets												
All Currencies	16,001.0	19,180.0	20,250.4	20,701.1	1,060.4	2,265.9	570.2	1,033.3	1,080.5	533.2	533.2	533.2
(a) Domestic currency	6,398.5	8,059.7	8,278.1	8,414.9	435.6	1,082.2	297.2	399.1	471.1	175.8	175.8	175.8
US dollar	1,319.8	1,677.1	1,787.8	1,862.0	72.9	357.3	103.4	-70.4	181.1	74.2	74.2	74.2
Euro	4,006.3	5,181.6	5,217.5	5,277.7	379.1	667.0	204.1	339.6	258.3	82.8	82.8	82.8
Yen	332.4	362.9	392.3	385.1	-58.5	18.9	-1.5	32.4	19.8	2.4	2.4	2.4
Pound sterling	479.9	543.6	582.3	579.2	37.6	23.5	-0.9	74.0	7.6	5.8	5.8	5.8
Swiss franc	76.8	91.5	89.4	87.7	-20.5	6.8	1.5	2.4	6.9	-1.4	-1.4	-1.4
Other	183.3	203.0	208.8	223.2	24.8	8.7	-9.5	21.1	-2.6	12.1	12.1	12.1
(b) Foreign currency	8,628.8	10,005.2	10,858.0	11,137.8	603.6	1,066.8	229.7	660.8	600.6	316.7	316.7	316.7
US dollar	5,042.8	5,678.6	6,408.6	6,568.1	421.4	612.8	246.5	375.5	343.2	159.5	159.5	159.5
Euro	2,020.2	2,378.8	2,443.5	2,520.2	119.3	179.8	-44.3	224.6	129.2	87.8	87.8	87.8
Yen	452.9	546.8	509.4	496.3	9.2	80.5	27.3	-43.1	33.8	-0.7	-0.7	-0.7
Pound sterling	404.0	520.1	541.5	567.5	56.3	78.1	5.4	49.2	12.5	34.5	34.5	34.5
Swiss franc	204.7	228.5	238.0	232.8	-2.4	3.3	-9.0	5.7	26.5	-4.2	-4.2	-4.2
Other	504.2	652.3	717.1	753.0	-0.1	112.4	3.8	48.8	55.3	39.7	39.7	39.7
(c) Unallocated	973.8	1,115.1	1,114.2	1,148.5	21.2	116.9	43.3	-26.7	8.8	40.7	40.7	40.7

Liabilities										
All currencies	15,359.1	18,111.6	19,095.4	19,606.2	1,000.0	2,013.3	470.8	941.3	885.1	588.2
(a) Domestic currency	6,133.1	7,488.4	7,644.2	7,852.3	451.4	910.3	253.0	250.1	401.9	246.5
US dollar	1,727.4	2,115.6	2,177.3	2,318.7	125.4	360.5	137.0	-98.2	159.9	141.4
Euro	3,252.3	4,077.7	4,087.9	4,161.2	254.6	488.2	113.0	270.9	140.7	94.7
Yen	233.1	240.9	289.8	264.9	-8.4	1.2	-5.7	31.6	33.4	-18.1
Pound sterling	618.3	720.1	726.1	749.8	57.1	48.5	7.9	42.2	18.1	35.0
Swiss franc	72.6	74.1	76.3	69.4	-6.4	-5.1	-7.5	8.5	3.3	-6.6
Other	229.3	259.8	286.7	288.2	29.1	17.0	8.4	-5.0	46.5	0.2
(b) Foreign currency	8,424.8	9,700.8	10,488.0	10,758.9	526.6	998.5	189.5	720.0	478.0	306.6
US dollar	5,042.2	5,649.4	6,243.7	6,422.9	368.1	607.9	225.4	355.9	244.9	179.1
Euro	1,665.7	2,004.4	2,095.2	2,147.7	120.0	181.5	-21.6	237.7	102.0	61.9
Yen	363.0	433.1	445.5	438.8	-78.1	61.0	15.6	13.1	22.8	4.2
Pound sterling	511.1	626.0	654.8	656.3	79.8	71.7	-2.9	52.9	24.9	11.5
Swiss franc	243.6	271.2	263.9	263.1	-18.0	-6.0	-4.8	3.6	22.9	0.2
Other	599.2	716.7	784.8	830.1	54.9	82.4	-22.1	56.7	60.4	49.6
(c) Unallocated	801.2	922.5	963.2	995.0	22.0	104.5	28.2	-28.8	5.2	35.1

Notes: * The reporting institutions are deposit-taking banks and similar financial institutions. In some countries, specialised non-deposit-taking, trade-related financial entities also report. More rarely, the coverage extends to some international operations of a central bank office, or, for certain items only, the banking department of a central bank. For almost all countries, the reporting banks account for well over 90%, and in many cases virtually 100%, of the international assets and liabilities of all banking institutions operating within their borders.

Source: Bank for International Settlements (BIS).*

yen was at \$496.3 billions and the Swiss franc was \$232.8 billions.¹⁸ In 2005, the US dollar constituted 59 per cent of the foreign exchange assets held by banks and financial firms in these 36 reporting jurisdictions.

In the other half of Table 2.2, the aggregate currency composition for *domestic currency* covers cross-border bank liabilities. On the liability side, the US dollar trails the euro in cross-border liabilities denominated in domestic currency with \$2,318.7 billions (2005) as compared to the euro's higher total value of \$4,161.2 billions (2005). However, as was the case with foreign exchange assets reported above, the US dollar constitutes a much larger portion of foreign exchange liabilities held by banks and financial firms with a total value of \$6,422.9 billions, as opposed to only \$2,147.7 billions in euros.¹⁹ UK sterling follows with \$656.3 billions, then the yen at \$438.8 billions and followed by the Swiss franc at \$263.1 billions. In 2005, the US dollar constituted 59.69 per cent (nearly 60 per cent) of the foreign exchange liabilities held by banks and financial firms in the reporting jurisdictions.

Based on this data, we can conclude that the US dollar constitutes a substantial portion of both the foreign exchange assets and foreign exchange liabilities held by private banks and financial firms. The banks and financial firms in these countries could have substantial exposure to any regulatory efforts by US authorities to impose extra-territorial controls on US dollar assets and liabilities that are booked, held and maintained by financial intermediaries in foreign jurisdictions. The data also suggest that the large relative size of the US economy and financial markets (e.g. US dollar) provides it with hegemonic economic influence over other states that have high levels of interaction and dependence on the US economy and that this could be an important factor in the design and effectiveness of US financial sanctions instruments, as will be discussed in Chapter 10. Moreover, the economies and financial sectors of the European Communities, Japan and other large emerging markets economies (ie., Brasil, China and India) have grown relative to that of the United States in recent years. This might suggest why these countries have begun to play a more proactive role in using economic sanctions. Naturally, other strategic and political factors have contributed to the increased use of economic sanctions by these states in recent years, including international obligations to impose sanctions under UN Security Council resolutions. However, the increased use of unilateral financial sanctions by some countries, such as Japan, the EU, and the UK,

¹⁸ UK sterling had increased from \$404.0 billions in 2003 to \$567.5 billions in 2005, an increase of \$163.5 billions, or 29%, whereas the Japanese yen only increased from \$452.9 in 2003 to \$496.3 in 2005, an increase of only \$43.4 billions or 08%.

¹⁹ The US portion of total foreign exchange liabilities had increased in absolute and relative terms from the 2003 figure of \$5,042.2 billions, which was an increase of 1,380.7 billions or 21%.

might be explained in part by the significant influence that their economies exert in the international financial system, whereas other countries with much smaller and less-developed financial sectors appear not to be using financial sanctions as much – possibly because of the relatively high costs of doing so.

V US hegemony and economic sanctions

Although US economic influence and its political authority have been in relative decline because of the economic rise of the European Union and China, the costly US-led invasion and occupation of Iraq and the 2007–2008 credit crisis, its role in the world economy and in military affairs remains unrivalled and indispensable. The US economic and military position in the world is similar, albeit with significant differences, to its position in the aftermath of World War II. During this period, the United States and the western powers embarked on building a new international economic regime by establishing international institutions and developing rules and principles of international trade which liberalized the world economy while blunting many protectionist policies. The establishment of such a system enabled the United States to maintain stability by increasing economic prosperity in most countries which adopted the standards and norms of the new international regime. Moreover, the US pursued a strategy that sought to strengthen political ties across the Atlantic in areas, other than military power (i.e. NATO), that were becoming more important as a result of regionalisation and increasing interdependence in international economic relations (Krasner, 1989, 56–59).

The United States now views itself as the remaining superpower with the responsibility of maintaining and spreading western principles of democratic capitalism and supporting US-inspired international institutions to resolve transnational disputes (Nye, 2003). Adherence to these principles requires respect for international law and maintaining security and stability in the international system. To that end, the United States has adopted stringent enforcement measures and economic sanctions against targeted states and terrorists organisations which challenge its hegemony.

The pre-eminent position of the United States in international trade and finance provides it with leverage to use economic sanctions to impose restrictions on transactions with foreign entities that may be financing transactions with targeted states. Moreover, the US uses export controls to restrict the sale of US-origin products and technology to any third country national who may re-export the item to a targeted state. The US government has justified the use of extra-territorial economic sanctions against third country states as an attempt to build a multilateral framework that is influenced by US economic and security interests. The disproportionately large size of the US economy and the substantial reliance of foreign firms and

financial markets on the US dollar as a reserve currency means that the US will exert a particular type of hegemony that combines economic prowess with military might to continue to impose economic sanctions against states and individuals designated by the US as security threats and to cajole and pressure its trading partners to do the same.

The hegemonic influence of the US economy and the substantial costs it can impose on countries through its economic sanctions programmes has been documented in several studies. For instance, the annual costs of US sanctions on the Iranian economy has been divided into trade sanctions and financial sanctions with Preeg (1999) showing that trade sanctions in the late 1990s resulted in between 700 million (US\$) and 1,000 million (US\$) per year, while financial sanctions imposed costs of between \$800 million and \$1,300 million per year for a total of between \$1,500 million and \$2,600 million per year. Preeg's study suggests that the costs imposed on the target state by trade sanctions and financial sanctions are approximately equal. Another study conducted by Askari *et al.* (2001) estimated a much lower cost for US trade sanctions against Iran that totalled about 27 million (US\$) per year, while far greater costs were imposed by US financial sanctions against Iran that ranged from \$1,160 million and \$1,321 million per year. According to this study, US financial sanctions imposed disproportionately large costs on the Iranian economy compared to US trade sanctions. Although strict US trade controls were in effect, they did not prevent circumvention through trade with third country states, especially those states whose territories bordered Iran and other states who were dependent on Iranian oil exports. Similar results were found by Torbat (2005) who estimated that US financial sanctions imposed much larger costs on the Iranian economy than trade sanctions.

In contrast, a 1999 study by the Institute for International Economics suggests that US trade sanctions imposed a greater cost on target states' economies than financial sanctions, but Rowat (2007) has observed that this study uses a much narrower definition of financial sanctions than the other studies which attribute much higher costs to financial sanctions. These studies regarding the costs imposed on Iran by unilateral US sanctions suggest that for trade sanctions to be effective there must be cooperation by states that are contiguous to the targeted states who are subject to the sanctions. This may not be necessary, however, with financial sanctions, as they are imposed through narrower commercial channels involving banks and other financial intermediaries and usually rely on one or a few reserve currencies (i.e. US dollar, euro, or yen) and therefore can be controlled more effectively by regulators especially when the target of the sanctions is a developing country or emerging market state, such as Iran, which has a great reliance on western banking facilities to finance its international trade, especially in energy sector commodities such as oil and gas.

In contrast, multilateral sanctions appear to have had more success in imposing significant costs on targeted countries. Indeed, the overall effectiveness of multilateral financial sanctions can be demonstrated by the various studies of the UN Security Council sanctions that were imposed against Iraq in the 1990s and were in place until 2003. Financial sanctions by all countries under the UN sanctions regime against Iraq imposed far higher costs on the Iraqi economy and society than trade sanctions. Although the Security Council maintained a comprehensive economic embargo against Iraq, trade restrictions were often circumvented by traders in contiguous states such as Jordan.

In May 2002, the Security Council adopted resolution 1409 that expressly provided for the use of 'smart' sanctions against Iraq and the Iraqi government leadership. It created tighter controls against financial transactions with Iraq and provided a more uniform framework of administrative procedures to control the export of goods and services to Iraq and provided clearer procedures regarding sales of oil for humanitarian assistance under the Iraqi oil-for-food programme (Rowat, 2001). Although the Iraqi sanctions programme succeeded in increasing costs on the Iraqi economy and restricting transactions with government elites, there remained significant loopholes and the rigidity of the sanctions regime prevented the UN sanctions committee from calibrating and adjusting the intensity of the sanctions during periods when, for instance, the Iraqi government had permitted access for UN weapons inspectors to Iraqi weapons sites. This created ambiguity regarding exactly what the Iraqi leadership needed to do in order to have sanctions relaxed. This contributed to the Security Council's failure to persuade Saddam Hussein to cease his efforts at acquiring the means to develop weapons of mass destruction, even though the sanctions regime itself was successful in preventing Hussein from acquiring such weapons.

This chapter examines some of the economic theories and empirical data in world trade and financial markets that can inform policymakers in devising more effective economic sanctions. Nevertheless, it should not be forgotten that economic sanctions can serve purposes other than imposing economic costs. The effectiveness of a state's sanctions programme does not necessarily have to be determined by the economic costs imposed on the target or by whether the target has changed its behaviour. Rather, a state's decision to impose sanctions may be motivated by the objective of defining the content of a norm, the breach of which justifies imposing the sanction. This important aspect of state practice is often overlooked in the economic sanctions debate. For instance, a state may impose sanctions merely to communicate to the target its dissatisfaction with its policies without necessarily expecting to impose significant economic costs on the target. Similarly, a state can impose sanctions with the primary intention of sending signals to third country states or persons who are not the direct targets with a view to influencing their behaviour towards the sanctioning state or the target.

Economic sanctions therefore can promote a number of objectives that do not necessarily involve changing the target's behaviour or imposing significant economic or social costs.

Conclusion

States are often required by the Security Council to adopt economic embargoes or targeted sanctions without regard for an assessment of how these economic controls will impact the sanctioning state's economy or the target state's economy. States incur differential costs when they impose sanctions due to different national economic structures and levels of development. Wealthy states usually can afford to incur the costs of imposing sanctions, while for developing countries the implementation of sanctions can result in disproportionately high costs. By calibrating the application of sanctions to market sectors where a state has a comparative or competitive advantage, states can become more effective in applying sanctions while doing so in sectors of their economies where they can afford the costs.

In addition, the comparative analysis of national economies and financial systems demonstrates the potential economic capacity of states in imposing economic sanctions. This is based on the notion that the relative size and value of a state's economy and financial system can play an important role in determining the effectiveness of a particular sanctions regime. Moreover, financial globalisation has resulted in increasingly integrated financial markets with an increasing number of cross-border capital flows and financial transactions. Growing linkages, however, between financial markets have allowed the regulators of economically powerful countries to exert disproportionate influence over transactions and firms that utilize certain currencies for their international transactions and to control the activities of foreign firms that do business in their jurisdictions. The following chapters will discuss the legal and regulatory framework on which the application of economic sanctions is based.

3

The International Legal Dimension of Economic Sanctions

Once therefore it is understood that law is a function of a given political order, whose existence alone can make it binding, we can see the fallacy of the personification of law implicit in such phrases as ‘the rule of law’ or ‘the government of laws and not of men’. ‘Law cannot be self-contained; for the obligation to obey it must always rest on something outside itself. It is neither self-creating, nor self-applying

E. H. Carr, *The Twenty Years’ Crisis* (1st edn, 1939) p. 229

I Introduction

International law embodies the rules, principles and processes that regulate the conduct of states and international organisations (Higgins, 1994, 2–3). As discussed in Chapter 1, Chapter VII of the UN Charter empowers the Security Council to require states to restrict and interdict economic relations with target states, entities, or individuals.¹ Outside the UN Charter or other applicable treaty, the customary international law of state responsibility regulates how, and the conditions under which, a state may impose economic sanctions.

The chapter examines some of the key international legal issues that relate to a state’s application of economic sanctions. Section I discusses the relevant principles and doctrines of the law of state responsibility as it relates to economic sanctions. It argues that, although the UN Charter provides an international legal framework governing the use of economic sanctions in certain circumstances, most states are free to impose economic sanctions on a unilateral basis and have done so increasingly in recent years to promote a wide range of public policy objectives – such as promoting human rights, supporting free elections, and protecting property rights. Nevertheless, a

¹ See the *Lockerbie cases, Preliminary Objections, Judgment, ICJ Reports 1998*, p. 9, 59 (*Libya v. United Kingdom*) and p. 115, 149 (*Libya v. United States*).

state's decision to impose unilateral economic sanctions is governed by the customary international law of retorsion and non-forcible reprisals, while the principles of reciprocity, proportionality, discrimination and necessity govern the type and extent of sanctions measures a state may impose.

Section II examines the important principle of jurisdiction in public international law and how it has evolved in state practice and is applied to support the application of economic sanctions. Economic globalisation and advances in technology have led states to adopt more expansive notions of prescriptive jurisdiction to regulate activities beyond their geographic borders that affect their economies and societies. Although most states accept that enforcement jurisdiction is territorially based (unless there are inter-state agreements to the contrary), many states are increasingly adopting statutes and regulations that seek to regulate extra-territorial conduct. Extra-territorial jurisdiction has attracted fierce criticism on the grounds that a state's regulation of conduct that occurs outside its territorial jurisdiction violates customary international law and that only in the most exceptional circumstances when fundamental norms of international law have been violated can states be justified in imposing extra-territorial jurisdiction. Section III examines certain areas of state economic sanctions practice to show the growing divide between states that adhere to more territorial approaches and the growing number of states that rely on expansive concepts of extra-territorial jurisdiction to promote their sanctions policies.

II International law and economic sanctions

The sources of international law and economic sanctions

The two most cited sources of international law are treaties and international custom.² Treaties create legally binding rights and obligations between states and can take the form of multilateral, regional and bilateral agreements,³ while international custom takes the form of customary rules or principles that must be evidenced by a general or uniform state practice with respect to the particular rule or obligation, and be accepted by states as a legal

² Oppenheim's *International Law* (1996, 24) states that 'custom and treaties... are the principal and regular sources of international law'. The sources of international law are enumerated in Article 38 of the Statute of the International Court of Justice and can be classified as follows: (1) treaties that establish rights and obligations expressly recognised by states; (2) international custom as evidence of a general practice of states and accepted by states as law; (3) general legal principles of the world's leading legal systems; and (4) subsidiary sources, including judicial and arbitral decisions.

³ Many treaties (though not all) contain procedures for enforcement or dispute resolution that allow state responsibility to be invoked under a treaty for breach of obligation that may result in liability and/or reparation.

obligation (*opinio juris*; *Ibid.*, 26–27).⁴ State practice forms the basis of customary international law. It consists of patterns of state behaviour or conduct that contain both material and subjective elements that are necessary for a state (or states) to form or maintain legally binding customary rules (Mendelson, 1996, 177).⁵ Further, state practice produces other norms, principles and regimes which are not viewed to be legal obligations, but which serve state interests because they are flexible and mutually reinforcing arrangements that crystallise into habits or customs of state action that are beneficial by virtue of their reciprocal nature and which are viewed to be in the long-term interests of the participating states.

Both customary international law and treaty law provide useful frameworks for analysing a state's economic sanctions policies. The extensive multilateral legal regime that has arisen at the UN Security Council to govern the adoption and implementation of economic sanctions under Chapter VII of the UN Charter and the regional treaty frameworks that govern the use of economic sanctions by the European Community and the Organization of American States (OAS) and other regional bodies have significantly influenced the development of state sanctions policy. Unilateral state practice, however, outside these treaty regimes remains the most influential determinant of the substantive content, procedure and scope of economic sanctions practice and regulation. The UN chapter VII framework does not provide the exclusive legal basis for states to impose economic sanctions, as states are relatively free under the rules of state responsibility in customary international law to adopt unilateral sanctions against states, entities and individuals.

Although not very influential in the economic sanctions debate during the Cold War, the Security Council began to play a more proactive role in

⁴ See also the discussion of customary international law in 'Military and Paramilitary Activities in and against Nicaragua (*Nicaragua v. United States of America*)', ICJ Reports (1986), p. 97, paragraph 183 (observing that to determine 'rules of customary international law', the court must look 'to the practice and *opinio juris* of states'); and in *The Lotus* case, Permanent Court of International Justice, series A, No. 10 (1927), p. 18 (emphasising the voluntary or consent-based nature of *opinio juris*); compare with *North Sea Continental Shelf* cases, ICJ Reports (1969), p. 3, paragraphs 71–72 and 78 (emphasising the belief-based nature of *opinio juris*).

⁵ The material element consists of actual deeds or action (e.g., administrative decisions and the adoption of regulatory rules) that are observable and manifest, while the subjective element consists of a state's intent, which may be manifested by certain acts or behaviour, such as official statements by heads of state or government, diplomatic correspondence or votes at international organisations, that provide evidence of a state consenting to or believing it has a legal obligation. Mendelson classified the subjective element as follows: (1) by the state's voluntary agreement or consent to be bound by the customary rule or obligation in question, or (2) by the state's belief that its conduct is legally permitted or obligatory (Mendelson, 1996, 184, 195).

devising and overseeing the implementation and enforcement of sanctions by member states in the 1990s. The Security Council sanctions regime has subsequently played an important role in shaping the economic sanctions policies and regulations of its member states, even though substantial variation between states persists. Based on state practice, certain principles are beginning to emerge in customary international law based on the regulations and legal principles adopted by states that have played an important role in setting the international sanctions agenda. These principles include equivalence and reciprocity in assessing the degree and scope of a country's use of sanctions, and proportionality in determining the permissible extent of sanctions when they are used as countermeasures against a target state for breach of a legal obligation.⁶

State responsibility and economic sanctions

In analysing the international legal principles governing the unilateral use of economic sanctions, the inquiry will focus on the principles and rules of customary international law that relate to a state's use of sanctions as a unilateral peacetime remedy. My framework of analysis divides unilateral economic sanctions into three categories: (1) retortive measures, (2) countermeasures/reprisals and (3) punitive sanctions. The legality of these measures under international law are governed by different principles and rules that apply in each category. In determining the legality of a particular sanctions measure, it is necessary to consider its purpose and probable effect on the target state, and to examine the applicable principles that govern its application. It is submitted that the design of a coherent and effective sanctions policy must take these factors into account. Too often, however, states undermine the efficacy of their sanctions policies by designing specific sanctions measures that are not rationally related to achieving their stated objectives.

Retorsion

A state may take measures in retorsion that impose economic, social or reputation costs against the targeted state or its nationals, but which do not breach international legal obligations to the targeted state. These measures are usually responses to measures taken by the targeted state that either infringe an interest or a legal obligation to the sanctioning state. The sanctioning state's retortive measures can include, but are not limited to: restricting trade with

⁶ Economic sanctions can be classified as non-forcible reprisals. An international arbitration tribunal in *The Naulilaa Case* set forth the three conditions for the lawful use of reprisals (forcible and non-forcible): (1) existence of a breach of international obligation; (2) the making of an unfulfilled demand for redress; and (3) observance of the principle of proportionality. *Annual Digest of Public International Law Cases* vol. 4, 1927–28, pp. 526, 527, para. (a) & (b).

the target state (that does not otherwise violate a treaty commitment), exerting pressure on foreign firms in third countries not to do business with the target state, or suspending economic assistance or state aid to the target state.⁷ The use of retortive measures by the sanctioning state is a response to the target state's opposing foreign policy or breach of legal obligation to the sanctioning state, but the measure taken by the sanctioning state does not breach a legal obligation to the target state.⁸

Retortive measures seek to restore the initial conditions that existed between the states before the target state engaged in the conduct that infringed the aggrieved state's interests. In the absence of effective international institutions for dispute resolution, states are generally free under customary international law to take self-help remedies that aim to restore an equivalence of conditions with the target state (Zoller, 1984, 50). The principle of reciprocity can be applied moreover to determine whether the sanctioning state's measure has restored the initial equivalence of conditions between the parties.⁹ If it is impracticable, however, for the measure to restore equivalence, the principle of proportionality should apply to determine the permissible scope and extent of the measure. A state's sanctions measure in retorsion should be viewed as a 'corrective measure' carried out to remedy inequity and to re-establish fairness between the parties, and the principle of reciprocity can determine if equivalence has been restored between the parties.¹⁰

In theory, once the measure in question has achieved an equivalence of conditions between the parties, and the target state reverses its repugnant conduct, the sanctioning state's measures should be lifted.¹¹ Moreover, an economic sanctions measure in retorsion may also seek to obtain restitution

⁷ For example, the US Congress adopted the Hickenlooper Amendment in the 1961 US Foreign Aid Act that required US federal agencies to terminate all state aid to countries that had taken property without paying adequate compensation as required by international law. At the time, Cuba was the main target of this aid cut-off (Alexander and Mills, 1995, 140–142).

⁸ This could take the form of Export-Import Bank support or lack of support. See US Export-Import Bank Act 1945, section 2(d) (requiring the bank not to approve credit in support of US exports to any country designated by US as not supporting US foreign policy (i.e., anti-communist)).

⁹ The domestic law equivalent of reciprocity applies under the law of contracts when one party's breach entitles the wronged party not to perform a counterpart obligation – the so-called *exceptio non adimpleti contractus*. Under both international and domestic law, the reciprocity principle incorporates Aristotelian notions of commutative justice.

¹⁰ Zoller (1985, 26), however, interprets reciprocity by equivalence under international law as involving countermeasures against breaches of treaties only, and not breaches of rules of customary international law (Zoller, 1985, 26).

¹¹ For example, the US Office of Foreign Assets Control regulations impose blocking orders against the assets within US jurisdiction of targeted states, designated

or compensation when the damages suffered by the sanctioning state are particular and not generalised to the whole sanctioning state. This may involve imposing special taxes on certain services or tariffs on goods imported from the targeted state for industries that have been harmed by some restrictive measure taken by the target state in breach of a legal obligation to the sanctioning state. Moreover, a state that takes an equivalent measure in retorsion against a targeted state is crucially not subject to a proportionality test, which would normally be applied if the sanctioning state had taken a measure that was a breach of obligation to the targeted state.

An arguable example of retorsion was the unilateral US trade embargo of Cuba in 1963 and the US legislation terminating US state aid to Cuba (the so-called Hickenlooper Amendment of 1962) in response to the Cuban nationalisations of 1959 and 1960 that resulted in the Cuban government confiscating property owned by US nationals and companies in violation of the customary international law rule to provide adequate compensation to the foreign owners of expropriated property. The US had maintained that at the time it took these measures it had no international legal obligation to maintain trade relations or to provide foreign aid to Cuba, and that its response to the allegedly unlawful Cuban nationalisations was an act of retorsion, and not a countermeasure or reprisal, which meant the US actions were not subject to the rules on countermeasures and thereby not subject to the proportionality principle.¹²

Countermeasures

The second category of sanctions is countermeasures, which are also known as non-forcible reprisals, which refer to any response or remedy to a prior unlawful act of a foreign state, the effect of which is non-compliance with one or several international obligations.¹³ Breaches of treaties and customary

terrorists and drug traffickers with the goal that once the target state or designated person ceases their undesirable conduct then the US will lift the blocking orders.

¹² The counter argument to the US position, however, holds that because the US was a member of the Organization of American States (OAS) it was obliged under article 19 of the OAS Charter not to treat signatory states such as Cuba in a discriminatory manner, and that the trade embargo was an act of trade discrimination against Cuba that, although not violating customary international law, it violated article 19, and therefore could only be justified as a countermeasure with the rules of reprisal applying and not retorsion. Essentially, because of its membership in the OAS, the US unilateral measure was transformed from a measure of retorsion to a countermeasure (a legitimate reprisal taken in response to an unlawful act). This means that the principle of proportionality would apply to the US countermeasures of imposing a broad-based trade embargo and financial sanctions against Cuba for its uncompensated taking of US-owned property.

¹³ The term 'countermeasures' was first used by an arbitral tribunal in the 1978 Air Service Award (France v. United States). See Case Concerning The Air Service

international law may entitle a state to take reciprocal or equivalent countermeasures that can include economic sanctions.¹⁴ For example, this means that state A could impose sanctions that breach an obligation to state B for state B's breach of obligation to state A, which could only be justified under international law if the obligation breached by state A was equivalent or of the same kind or type as the obligation breached by state B. In other words, state B's breach against state A could expose state B to a retaliatory, but equivalent, breach by state A. The principle of proportionality would determine whether state A's breach of obligation to state B was equivalent to state B's breach. Also, the sanctioning state could adopt an equivalent countermeasure that was a breach of another legal obligation of similar type or kind than that owed by the target state. For instance, a trade embargo in violation of a bilateral trade agreement could be a reprisal against a target state's breach of an equivalent, but not identical, obligation under customary international law to provide compensation to the foreign owners of nationalised property. The principle of proportionality though would require that the application of the embargo not be overly broad and be proportionate to the economic and social costs arising from the uncompensated taking. In the *France-US Air Services Award*, the tribunal observed that adopting a proportional countermeasure can only be done at best by approximation, and that it is 'essential, in a dispute between States', to take into 'account not only the injuries suffered' but also 'the importance of the questions of principle arising from the alleged breach'.¹⁵

Regarding the breach of an obligation in a bilateral or multilateral treaty, reciprocity by equivalence would ordinarily apply to determine the type of countermeasure necessary to re-establish equivalent conditions arising from the breach of a corresponding or similar type or kind of obligation.¹⁶ Moreover, the *France-US Air Services Tribunal* held that the legality of the countermeasure could be determined by the reciprocity principle calculated in economic terms, and by the need for the aggrieved state to pressure the target state to agree to a quick settlement procedure, or by the exemplary character of the measure in question directed at other countries.¹⁷ If a breach

Agreement of 27 March 1946 Between the United States of America and France (9 Dec. 1978) hereinafter *France-US Air Service Award*]. Elagab (1988, 2) notes that the term 'countermeasures' was first coined by British lawyers in 1916.

¹⁴ See *France-US Air Services Award*, para. 82 where the arbitration tribunal observed that '[i]t is generally agreed that all counter-measures must, in the first instance, have some degree of equivalence with the alleged breach; this is a well-known rule.'

¹⁵ *Ibid.*, para. 83.

¹⁶ The importance of reciprocity as a countermeasure has been emphasised by eminent jurists. Former International Court of Justice Judge Stephen Schwebel stated that reciprocity was the norm in international law (Schwebel, 1981, 181).

¹⁷ *Ibid.*, para. 78.

of international obligation in a treaty cannot be redressed with a reciprocal action (e.g., no reciprocal countermeasures available), the wronged party is entitled under customary international law to resort to non-performance of another international legal obligation to the offending state.

Punitive sanctions

The third category of measures involves punitive sanctions that include both coercive and punitive elements. The coercive element is composed of measures intended to deter future misconduct and therefore is forward-looking in seeking to influence the target state's future behaviour, whereas the punitive element seeks restitution and redress for past wrongs which can take the form of full-value compensation, a penalty or fine. The punitive measure is geared towards the past, but also can be exemplary in character so as to deter others from pursuing the same or similar conduct. For instance, the US Helms-Burton Act of 1996 (discussed in Chapter 7) contains both coercive and punitive elements that, inter alia, allow the former owners of confiscated Cuban property to recover treble damages based on the value of their confiscated Cuban property against third country persons who have benefited from such property. The private right of action provides a remedy for former Cuban property owners to seek full-value compensation, while the treble damages component can potentially punish those who have knowingly benefited from confiscated Cuban property. The measure's exemplary character seeks to warn others that they should not engage in transactions with confiscated Cuban property, while the compensatory damages provisions seek to provide redress for those who have lost their property.

Third country states can also use punitive sanctions to punish a state for violating *jus cogens* international norms. This allows other states (not just the state whose nationals suffered direct injury) to resort to countermeasures against the offending state. For instance, a third party state could impose an embargo or more specific travel bans or financial sanctions as a lawful countermeasure so long as the fundamental norm which has been breached by the target state is universally recognised and the breach is indisputable. This is because international crimes/wrongs (breach of *jus cogens* norms) committed by a state are graver than the international delicts that arise from breaches of rules of customary international law, thereby justifying countermeasures by all members of the international community. But the scope of countermeasure is still limited by the doctrine of proportionality which essentially provides that a state that commits such grave breaches of international law can be subjected to countermeasures, but not to infringements of international humanitarian law (e.g., extreme social and economic deprivation), by other states (Zoller, 1985, 119–120).

The British government first adopted unilateral economic sanctions against Burma in the 1990s on the grounds that the Burmese military

government had breached international humanitarian law by cancelling democratic elections and imprisoning a number of political opponents who had advocated that the military government cede political control to a democratically elected government. The British sanctions have mainly been composed of targeted restrictions on British banks and companies doing business with the Burmese government and targeted financial sanctions and visa restrictions on senior members of the Burmese military government. Although the British sanctions have been criticised on the grounds of not achieving their main objectives of forcing the military regime to allow verified democratic elections and to release its political opponents,¹⁸ their targeted nature represents a more proportionate approach in using sanctions to promote democratic reform without imposing severe economic and social costs on the Burmese people. British sanctions policy against Burma is based on the violation by the Burmese government of fundamental *jus cogens* norms of international humanitarian law and not because the Burmese government has breached a specific legal obligation to the United Kingdom or poses a threat to peace and security under chapter VII of the UN Charter. British sanctions have delivered a message to the Burmese regime that they must institute democratic reforms and respect international labour standards if UK sanctions are to be lifted. The targeted economic sanctions that the UK government have applied are generally proportionate, even though they may not have achieved their specific objectives of democratic elections and a release of political prisoners.

Unless there is a specific treaty obligation to the contrary, therefore, states have the authority under customary international law to impose economic sanctions against other states or parties regardless of whether the target of the sanctions has breached an international legal obligation against the sanctioning state. Based on this liberal framework, states have been relatively unconstrained in their use of economic sanctions throughout recent history and the basic features of most nation's economic sanctions programmes have evolved to take account of the changing nature of security threats and the changing structure of international trade and finance. In fact, state practice in the post-World War II period has generally accepted the non-military use of economic sanctions or primary boycotts as a legitimate instrument of coercion to accomplish foreign policy or national security objectives (Elagab, 1988, 39–44; Baade, 1995, 443).

Some academics argue that customary international law contains certain legal standards that govern a state's use of economic sanctions.¹⁹ Reisman and Stevick (1998) suggest that the international legal principles of

¹⁸ House of Lords Select Committee on Economic Affairs, 'The Impact of Economic Sanctions' (9 May 2007) p. 18.

¹⁹ See Reisman and Stevick (1998, 127–129).

proportionality, discrimination and necessity should apply to the scope and intensity of a state's economic sanctions measures.

As discussed above, the proportionality principle is important in designing a sanctions programme, especially if the sanctions are a response to a legal breach of obligation by the targeted state. Proportionality would hold that a sanctioning state must calculate the foreseeable economic, social and political effect of the prospective sanctions instrument (i.e., economic embargo) and assess whether it will lead to equivalent costs against the target or derive some equivalent benefits for the sanctioning state to offset its loss. For instance, a broad economic embargo would not be a proportional sanctions instrument in response to a state which has either directly or indirectly damaged industrial property owned by a company of the sanctioning state.

The discrimination principle involves the degree of precision that should be applied to a particular set of sanctions measures. For instance, the objective of Security Council resolutions 678 and 687 was to deny Iraq the economic means to develop weapons of mass destruction (WMD). This was a proportional sanctions objective given Iraq's invasion of Kuwait in August 1990 and Saddam Hussein's rhetoric to commit aggressive acts against other Arab states. However, the design of the UN sanctions programme was overly broad, as it imposed a complete economic embargo on Iraq with limited exceptions to ameliorate human suffering. Although the sanctions achieved their objective of denying Saddam the means to develop his WMD programme, they imposed substantial collateral damage on the Iraqi economy and society that could have been avoided while achieving the sanction's objectives.²⁰ Rather, a more narrowly tailored, discriminating sanctions programme would probably have been able to prevent Saddam from obtaining the necessary materials to develop a WMD capacity.

Discriminating sanctions can involve asset blocking orders against individuals and firms, export controls on specific products and services, and travel bans for senior government and business elites. These so-called 'smart sanctions' are in theory capable of being more discriminate and effective in their capacity to bring about the desired change or objective of the sanction's policy. The need for discriminating sanctions may be more necessary in a totalitarian society than a democracy because a large-scale embargo against the whole population of a totalitarian state may not lead to effective pressure on political elites to bring about the desired change, whereas by imposing an embargo on the whole economy of a democracy this might bring sufficient political pressure through elections to achieve the desired sanctions objective. The main point, however, is that given the experience of UN sanctions against Iraq, the goal of discriminating or smart sanctions should be to mitigate the social destructiveness of sanctions

²⁰ See House of Lords Select Committee on Economic Affairs (2007).

programmes by using more limited and precise sanctions to achieve the same policy objective (Reisman and Stevick, 1998, 129–134).

The third principle is necessity which involves a weighing and balancing of the sanctions measure in question and whether it is rationally related to achieving the sanction's objective (e.g., changing the target behaviour or signalling to other countries or persons) and whether once the objective is achieved what type of procedure is in place to withdraw the sanction. The necessity test would not be solely based on allowing a state to decide whatever measure it believed to be necessary to achieve the objective, but rather that its sanctions programmes should be subject to some type of empirical assessment regarding whether they are in fact having a meaningful effect on achieving their objectives. For example, economic sanctions should be necessary in a policy sense in so far as they should have economic impact on the target economy (e.g., reduced trade and investment resulting in lower levels of economic growth) and that this should have some effect on political groups who hold power to make desired changes. Once it is established that sanctions are effective in an economic and political sense the sanctions regime should have in place a set of contingencies to mark at what point sanctions should be loosened or lifted completely once the objectives have been met or when the sanctions are shown to lack proportionality or to be ineffective in meeting their objectives. These three principles should guide state practice in designing and applying national sanctions programmes and for operating the UN's multilateral sanctions regime. By complying with these standards, a state can ensure that its sanctions policy is effective and legitimate.

III Evolving principles of international jurisdiction

The application of economic sanctions in state policy is also governed by the concept of jurisdiction in international law.²¹ A state's jurisdictional authority to prescribe laws, adjudicate cases and enforce its judgments derives primarily from its sovereignty.²² Most nations generally recognise

²¹ Generally, jurisdiction takes three forms: (1) jurisdiction to prescribe involves the enactment of laws or regulations to govern certain persons, property or activities; (2) jurisdiction to adjudicate involves the power or authority of a court or tribunal to hear or decide a case; (3) jurisdiction to enforce involves the power of a state to enforce its rules and judgments. It is important to keep these three types of jurisdiction separate as a state and/or its courts may have one type of jurisdiction but not the other. Moreover, a state may agree to delegate its authority to adjudicate cases to a nonjudicial tribunal or to delegate enforcement to another country's courts. See Henkin (1995, 255–260).

²² Jurisdiction, however, is not co-extensive with state sovereignty (Jennings and Watts, 1992, 457, citing the *Lotus* case, PCIJ, Ser. A, No. 10, p. 19). Oppenheim interpreted sovereignty as comprising the external and internal independence of a

four bases of jurisdiction to prescribe public law: (1) Territorial, (2) Nationality, (3) Protective and (4) Universal (Henkin, 1995, 232). The exercise of prescriptive jurisdiction over persons, territory, property and acts or events has varied across states depending on a country's historic and geographic development (Starke, 1984, 496–497). The customary international law of jurisdiction governs the permissible range and scope of most states' economic sanctions programmes. States, however, interpret their jurisdictional authority differently, especially with respect to extra-territorial conduct. This poses a challenge for national policymakers in devising economic sanctions programmes that are based on robust jurisdictional principles, but which respect international norms and the legitimate interests of other states.

Territorial principle

The ancient Greeks recognised the primacy of geographic territory as an essential element in the sovereign jurisdiction of a particular society (Gottmann, 1973, 27). Roman law, in contrast, placed more emphasis on ties of personal allegiance and religion, rather than on territory.²³ For a millennium after the Roman Empire, the 'significance of territory in Europe was to be reduced to very little indeed, even on the local level' (Ibid.). This began to change, however, in the early sixteenth century as European states began to define themselves and their political prerogatives in terms of territory. Indeed, by the mid-seventeenth century, the Westphalian concept of territory as the primary basis for legal authority and political power was predominant.²⁴

Most modern academic treatments of the principle of jurisdiction in international law are derivative of Kelsen's classic analysis of jurisdiction in *A General Theory of State and Law* (1949, 208–212). Although he accepted the

state with respect to its liberty of action outside its borders as well as its liberty of action inside its borders, and involving territorial authority over all persons and things within its territory (Jennings and Watts, 1992, 382).

²³ The Roman attitude was predicated upon the creation and defence of a large empire, with relatively fluid borders, across which Roman citizens and persons would move, and would have their conduct subject only to Roman law.

²⁴ De Visscher observed that '[h]istorically the territorial home of the State is the foundation of the political and legal order born in the sixteenth century and definitively consecrated in Europe by the Treaties of Westphalia' (1957, 195–196). See also discussion in Starke (1984, 193–194). The territorial primacy of state jurisdiction was recognised by former World Court Judge Huber (sole arbitrator) in the *Island of Palmas* case (1928) who observed that 'the first and foremost restriction imposed by international law upon a State is that – failing the existence of a permissive rule to the contrary – it may not exercise its power in any form in the territory of another State' (Award of the Permanent Court of Arbitration in the *Palmas Island Case*, Netherlands-United States, p. 16).

traditional view that a state's ability to exercise its coercive power over individuals and firms was confined to its territorial boundaries, Kelsen recognised that it was 'not impossible' for a state to prescribe general or individual norms of its legal order to persons or things outside its territory, but it would be 'illegal' under international law for the state asserting jurisdiction to attempt to enforce or execute its norms by a coercive act within the territory of another state without that state's consent (Ibid., 208). For states to co-exist without conflict, it was necessary for international law to delimit the territorial spheres of validity of the various national legal orders.²⁵ International law's territorial limitation on the unilateral enforcement by one state of its laws in another state applied only to its coercive acts in another state and the procedures which led to them. He observed, however, that, despite the prohibition against a state enforcing its norms in the territory of another state, it could regulate the behaviour of individuals in another state's territory. In other words, states could condition the application of sanctions against a person within their territory for behaviour or omissions that occurred in another state's territory.²⁶

Similarly, regarding extra-territorial criminal jurisdiction, Jennings and Watts (1992, 468) took the view that states could impose jurisdiction over the acts of foreigners committed in foreign states if these acts were performed in preparation of and participation in common crimes committed or attempted to be committed in the country asserting jurisdiction. Under these circumstances, extra-territorial criminal jurisdiction could be imposed on foreign persons for committing acts abroad that injure nationals of the state asserting jurisdiction or which threaten the safety and security of the state.

During the nineteenth century, the territorial principle was the primary source of jurisdiction under the English Common Law; it was also accepted in US courts and in other common law jurisdictions as the primary, if not exclusive, basis of jurisdiction until well into the twentieth century. The principle was expressed by Lord Macmillan:

It is an essential attribute of the sovereignty of this realm, as of all sovereign independent States, that it should possess jurisdiction over all persons and things within its territorial limits and in all causes civil and criminal arising within these limits.²⁷

²⁵ He defined a state's territorial sphere of validity to be 'the space within which the acts of the State and especially its coercive acts are allowed to be carried out' (Ibid., 209).

²⁶ He observed that a state 'could attach sanctions to delicts committed within the territory of another State'. See Kelsen (1949, 209).

²⁷ *The Cristina* [1938] AC 485, 96–97 (per Lord Macmillan).

According to English law, the mere physical presence of any person or thing within the territory is sufficient to attract jurisdiction without the necessity for either domicile or residence (Dicey and Morris, 1993, r. 24, 303–310).²⁸ Parliamentary statutes are presumed to apply exclusively to persons, property and events in the territory over which it has territorial jurisdiction,²⁹ unless a contrary intention appears, and statutes are construed with reference to this presumed intention.³⁰ US courts use a similar rule of construction. Similarly, under most common law jurisdictions, the territorial scope of legislation that creates a criminal offence employs the presumption against extra-territorial application, for the law is treated as applying only to acts and omissions taking place in the territory of the legislature.³¹

In the late twentieth century, however, the growth of multi-national enterprises, the liberalisation of international markets, and the rise of electronic commerce have significantly reduced the relevance of territory as a basis for jurisdiction. Similarly, systemic changes in the structure of the international system have circumscribed the power and influence of states within their own territories. Indeed, advances in technology and military weapons have diminished the importance of geographical boundaries in protecting the inhabitants of a territory. Many scholars have postulated that these developments have resulted not only in a diminution in the power of the nation state but also in a decline of the Westphalian system of international law based fundamentally on sovereign territorial states (De Visscher, 1968, 405; Dembinski, 1975, 145).

²⁸ See also, *South India Shipping Corp. Ltd., v. Export-Import Bank of Korea* [1983] WLR 585, [1985] 2 All ER 219 (CA). Indeed, under the so-called ‘transient jurisdiction’ a English court may impose jurisdiction on a person who is served with a writ during a mere fleeting presence in British territory. *Colt Industries, Inc. v. Sarlie* [1966] 1 WLR 440 (in civil matters, English courts will assume jurisdiction over non-resident alien defendants if a writ is served on them while visiting the UK temporarily, even though the cause of action arose abroad).

²⁹ See *Holmes v. Bangladesh Biman Corporation* [1989] 1 AC 1112, 1126, 1132–1133, 1135–1138; see also Jennings and Watts (1992, 82).

³⁰ See *Wanganui-Rangitikei Electric Power Board v. AMP Society* (1934) 50 CLR 581. Moreover, Australian law also provides for such a presumption as stated in section 21 (b) of the Acts Interpretation Act of 1901, which provides that ‘In any Act, unless a contrary intention appears... references to such localities’ jurisdictions and other matters and things shall be construed as references to such localities’ jurisdictions and matters and things in and of the Commonwealth’.

³¹ *Goodwin v. Jorgensen* (1973) 128 CLR 374, 383; *MacLeod v. Attorney General of NSW* [1891] AC 455, 458; *Cox v. Army Council* [1963] AC 48, 67. The exercise of territorial jurisdiction has also traditionally included the territorial sea or maritime coastal belt, a ship bearing the flag of the state seeking jurisdiction, and ports.

Territorial jurisdiction and economic sanctions

The territorial principle holds that a state's application of economic sanctions against a targeted state is limited to all trade emanating from the sanctioning state's territorial jurisdiction and to all nationals of the sanctioning state, wherever they may be located, who conducted trade with the targeted state. In the late nineteenth century, some states during hostilities applied the doctrine of continuous voyage which treated the carriage of goods from a belligerent state to a neutral state port, and then onwards to another belligerent state, as one 'continuous voyage' as if the traders in each belligerent state were trading directly with each other without the interposition of the neutral state (Trotter, 1940, 39–42). The doctrine applied if the 'whole transportation' of the goods was pursuant to a pre-conceived single transaction and would not be applicable if the goods were intended merely for a neutral port in the hope that they would later be traded on to a hostile state. During the Boer War and the Russian-Japanese War 1904–05 the doctrine was applied aggressively by belligerent states with the effect that it significantly restricted trade by persons in belligerent states with traders in neutral third countries.³² This led to protests from neutral countries and to efforts to eliminate the practice that culminated in its abrogation under Article 35 of the Declaration of London 1909.

Nevertheless, by the outbreak of World War I in August 1914, the British Parliament had not yet adopted the necessary legislation to implement Article 35 into UK law. Rather, the British government, by Order in Council in October 1914, adopted a modified version of Article 35 that effectively waived the doctrine of continuous voyage except in circumstances where there was a likelihood that the goods could be traded onwards for the benefit of the enemy.³³ These exceptions were broad enough to allow the British government to continue applying the doctrine effectively throughout the war. Moreover, the British government enacted embargo legislation against enemy states and their nationals and wide-ranging controls on UK trade and investment with neutral countries if it directly or indirectly benefited Germany and its allies.³⁴

³² See discussion in *The 'Mashona'* [1900] 17 Buchanan, 135 (S. Ct. Cape Town).

³³ The Order in Council allowed UK authorities to seize 'conditional contraband' on board a ship destined for a neutral port if the goods were consigned 'to order', or if the ship's papers did not identify 'the consignee of the goods', or if 'a consignee of the goods' was in enemy or enemy-occupied territory. See Trotter (1940, 41).

³⁴ Trading with the Enemy Act 1914 (TWEA) 4 & 5 Geo. V, c. 87, repealed by TWEA 1915, 5 & 6 Geo V, c. 79, extension of powers under 1915 Act adopted c. 98; repealed by TWEA 1916, 5 & 6 Geo. V, c. 32; see also, TWEA (Copyright) 1916; TWEA 1918, 8 & 9 Geo V, c. 31. The extra-territorial nature of the UK trade controls has been documented in the literature (Trotter, 1940; Domke, 1943).

Although these measures were justified on the grounds of wartime emergency, they nevertheless were an extra-territorial infringement of the rights of third country states, such as the United States, to engage in international commerce. Later, when the US joined the war in 1917, it adopted the Trading with the Enemy Act of 1917 that allowed it to impose similar extra-territorial controls on US trade with neutral countries that could directly or indirectly benefit Germany and its allies. Similarly, during World War II, the UK and US governments adopted trading with the enemy legislation and related secondary legislation and regulations that imposed similar economic controls on third country states and their nationals (Domke, 1943; Malloy 1990, 136–139). It was only during wartime that the implementation and enforcement of sanctions were largely effective and coordinated well between the allied powers, as well as between the axis powers. During the inter-war period, however, because the League's members, along with the US, lacked the political will to impose effective sanctions and to coordinate their extra-territorial application, sanctions were easily evaded by those who adapted their international trade patterns to avoid the territorial jurisdiction of states which had imposed limited sanctions.

Subjective territorial principle

Some states adopted the subjective territorial principle by arrogating to themselves a jurisdiction to prosecute and punish crimes commenced within their territory, but completed or consummated in the territory of another state. Although this principle has never been accepted as a binding legal obligation in the uniform practice of states, particular applications of this principle have been adopted in the provisions of two multilateral conventions, the Geneva Convention for the Suppression of Counterfeiting Currency (1929),³⁵ and the Geneva Convention for the Suppression of the Illicit Drug Traffic (1936).³⁶ Under these conventions, signatory states obliged themselves to punish, if occurring within their territories, conspiracies and intentional participation in the commission of counterfeiting and drug traffic offences regardless of which state or territory the final act of commission took place. These conventions authorised signatory states to punish both acts which are attempts to commit and acts preparatory to the commission of such offences.³⁷ Moreover, states were authorised to treat certain specific acts as distinct offences and not to consider them as

³⁵ See 1929 Convention for the Suppression of Counterfeited Currency and Protocol, 112 L.N.T.S., No. 2624, (20 Apr. 1929) [hereinafter Counterfeiting Convention].

³⁶ See 1936 Convention for Suppression of the Illicit Traffic in Dangerous Drugs, 198 L.N.T.S. No. 4648, 26 (June 1936) [hereinafter Illicit Drugs Convention].

³⁷ See *Public Prosecutor v. D.S.*, 26 I.L.R. 209 (1958, ii).

accessory to principal offences committed elsewhere. These conventions were significant because under prior state practice acts which were ancillary in nature to the principal criminal act occurring in another state generally were not punished by the states in whose territory the secondary offences occurred.

Objective territorial principle

A number of judicial decisions and commentators have analysed the objective territorial principle in a number of criminal and civil cases involving offences committed outside a state's territory but which took effect inside the prosecuting state's territory (Brownlie, 1990, 301). The classic example involves a person firing a gun across a border and killing another person in the territory of bordering state; another depicts someone obtaining money through deception by posting a letter in Britain intended to be delivered to a recipient in Germany, or someone instigating a conspiracy in one jurisdiction with someone in another country.³⁸

The most important international law case to illustrate the application of the objective territorial principle was the Permanent Court of International Justice's (PCIJ) decision in the *Lotus* case.³⁹ In *Lotus*, a French merchant ship *Lotus* collided with a Turkish collier *Bozkort* on the high seas and eight Turkish seamen drowned. Shortly thereafter, when the French ship called at Istanbul port, Turkish authorities arrested and charged the French ship's two watch officers with reckless homicide under Turkish criminal law. Both countries agreed to submit their dispute to the Permanent Court of International Justice.⁴⁰ Turkey argued that the burden was on France to demonstrate that international law contained a prohibitory rule precluding it from asserting criminal jurisdiction over the French nationals for allegedly committing an offence against Turkish nationals outside of Turkish territory – in this case, on the high seas. France argued that international law created a prima facie prohibition against a state applying its law extra-territorially unless the conduct it sought to regulate fell into one of several established exceptions, and that this dispute did not fall into one of these exceptions.

³⁸ *Board of Trade v. Owen* [1957] 602, 634 (CA); *R. v. Cox* [1968] 1 ER 410 at 414 (CA); *D.P.P. v. Doot* [1973] 807 (CA). See also objective territorial principle applied in cases of anti-trust in *Alcoa* 148 F.2d at 448. Brownlie suggested that extra-territorial application of anti-trust could be based not on effects doctrine but on protective principle of international jurisdiction (1990, 301) citing Jennings, (1957) 33 BYBIL 155, p. 161.

³⁹ The *Lotus* case, (Fr. v. Tur.), PCIJ, Ser. A, No 10 (1927).

⁴⁰ The decisions of the Permanent Court of International Justice, and later its successor the International Court of Justice, are only legally binding for the states who agree to submit their dispute to the jurisdiction of the court, and do not constitute legally binding precedent.

The court began its reasoning by stating that an exercise of power, including the enforcement of law, on another state's territory was forbidden:

Now the first and foremost restriction imposed by international law upon a state is that – failing the existence of a permissive rule to the contrary – it may not exercise its power in any form in the territory of another state. In this sense jurisdiction is certainly territorial; it cannot be exercised by a state outside its territory except by virtue of a permissive rule derived from international custom or from an international convention.

The court observed, however, that 'restrictions upon the independence of states cannot... be presumed' and that '[t]he territoriality of criminal law is... not an absolute principle of International Law, and by no means coincides with territorial sovereignty'. The court then refused to address directly the main issue raised by France and Turkey in the dispute, namely, whether international law permitted Turkey to impose extra-territorial jurisdiction for the violation of Turkish criminal law and instead framed the issue by analogising the Turkish ship with Turkish territory to argue that the French officer's conduct had resulted in a crime committed on Turkish soil, or, alternatively, which took effect on Turkish soil.⁴¹ The court held that Turkey could impose jurisdiction based on the objective territorial principle, which did not violate international law's presumptive prohibition against a state's extra-territorial application of its criminal laws.⁴² The court's version of the objective territorial principle applied the 'effects principle' to hold that the negligent act on board the French vessel had direct effect on the Turkish vessel, thus justifying Turkey's application of criminal jurisdiction.

Although it was not legally binding precedent, the court's decision influenced the development of the international law of jurisdiction and created what has become known as the Lotus presumption because it had assigned to France the burden of proving that Turkey's assertion of jurisdiction violated international law. Thus, France was required to prove that states had adhered to a uniform rule of international law that prohibited Turkey from asserting jurisdiction on the facts of the case. According to the Lotus presumption, states are free to assert their jurisdiction over extra-territorial conduct to the fullest extent permitted by international law, and any doubt regarding the precise scope of a state's jurisdiction is resolved in favour of

⁴¹ PCIJ, Ser. A, No. 10 (1927) p. 23.

⁴² A narrow majority of the court ruled for Turkey. The court's President, Judge Huber, tipped the balance in favour of Turkey. See 2 World Ct. Rep. P. 32 (Huber J). The other judges in the majority were: Judges Moore, de Bustamante, Oda, Anzilotti, and Pessoa; while the judges voting against Turkey's right to exercise jurisdiction over the French officers were: Judges Loder, Weiss, Lord Finlay, Nyholm and Altamira. *Ibid.*, 2 World Ct. Rep. Pp. 23, 46.

the state asserting jurisdiction unless the opposing state can demonstrate a prohibitory rule to the contrary.

The Lotus decision was a direct challenge to the more restrictive interpretation of territorial jurisdiction that had been adopted by many states, including the United Kingdom.⁴³ Henkin (1995, 230–231) criticised the decision for not providing an adequate enough examination of the concept of jurisdiction under international law.

Moreover, the public policy critique of the Lotus presumption is that it creates an incentive for states to assert their jurisdiction robustly on an extra-territorial basis and to refrain only if there is a clearly demonstrable rule or principle of international law to the contrary. Moreover, in many evolving areas of cross-border economic, social and political activity, international law has not yet provided detailed rules allocating jurisdiction between interested states. This legal uncertainty regarding the extra-territorial regulatory prerogative of states may encourage them to make contentious jurisdictional claims over extra-territorial conduct in order not to be seen as acquiescing to the jurisdictional claims or interests of other states. The court's ruling in Lotus that whatever is not prohibited is permitted under the international law of jurisdiction may have planted the seeds of jurisdictional conflict and uncertainty that remain with us today.

Moreover, a state's exclusive jurisdiction over persons, property and transactions within its territory has become less certain in today's globalised economy with its extensive cross-border dimensions. Indeed, a state's exclusive jurisdiction over affairs within its territory may imply restrictions on the exercise of extra-territorial jurisdiction by other states whose regulation of activities in the territorial state may implicate important state interests. Henkin (1995, 235) observed that it is 'unreal' and 'frivolous' to assert that the territorial state should be able to object to 'invisible radiations' into its territory by the laws of other states. But extra-territorial application of law to persons, activities and interests in other states may not be legitimate and adequate on the grounds that it creates invidious distinctions between individuals and firms in the territorial state, and the extra-territorial law may be unjust or oppressive and may violate the equal protection of the laws. More problematic, the application of extra-territorial law may create dual and contradictory obligations for persons in another state.

In addressing the problem of extra-territoriality, two general views have arisen. First, that the territorial state's jurisdiction is exclusive and that the extra-territorial application of the laws of a state to the persons, activities and affairs of other states can not be justified as it infringes their territorial sovereignty. Any exception to this rule can only be legally recognised by the

⁴³ Brownlie (1999, 304) comments that the judgment was 'unhelpful in its approach to the principles of jurisdiction, and its pronouncements are characterised by vagueness and generality'.

consent of the individual state concerned or by the general consent of all states with *opinio juris* so that the exception achieves mutual reciprocity. Second, that any restriction on a state's autonomy – including its right to apply its laws extra-territorially – must not be presumed in the absence of a prohibition or restriction to the contrary either recognised in customary international law or convention. The international state system has generated some limitations on the exercise of extra-territorial prescriptive jurisdiction that reflect state values and interests, but these limitations must not be presumed unless a state can demonstrate that customary international law or treaty contains a prohibition against extra-territorial jurisdiction. As a general matter, this means that although the territorial state is presumed to regulate all activity within its geographic boundaries, other states may extend their jurisdiction to such activity except where international law prohibits or restricts them from doing so.

In addition, US courts have recognised that the objective territorial principle includes an 'effects doctrine' which allows Congress to enact laws regulating activity outside US territory if it is reasonably foreseeable that such activity would produce substantial effects within US territory.⁴⁴ Indeed, the territorial impact of the extra-territorial activity is the crucial link that justifies extra-territorial jurisdiction. The US Supreme Court adopted a narrower rule for determining whether the effects doctrine supports the extra-territorial application of US anti-trust laws. In *California v. Hartford Fire Insurance*, the Court held that Congress could create extra-territorial subject matter jurisdiction over the acts of non-US defendants in foreign jurisdictions if it were reasonably foreseeable that such acts would have a direct and substantial effect on US commerce and if the imposition of extra-territorial jurisdiction did not create a "true conflict" with the laws of the foreign jurisdiction where the acts occurred.

Although most activity which occurs outside of US territory is not subject to the extra-territorial jurisdiction of US laws, the broad reach of US law in the area of anti-trust, economic sanctions, securities regulation and other areas of economic regulation has become a matter of concern to many countries. A number of countries, including the member states of the European Union, Canada, Mexico and Japan, have resented and protested, as excessive intrusions into their spheres of influence, broad assertions of authority by US courts (Born and Westin, 1992, 360–366). US courts have recognised this concern and have, at times, responded to it by balancing the use of the effects doctrine with both the requirements of foreign law and the rules of the conflict of laws.⁴⁵ In any event, it is evident that at some

⁴⁴ *Alcoa*, 148 F. 2d at 418–419.

⁴⁵ See *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597, 599 (9th Cir. 1976). See also *United States v. Brodie*, 174 F. Supp. 2d 294 (E.D. Pa., 2001; discussed in Chapter 8).

threshold point the interests of the United States may become too weak and the foreign harmony incentive for restraint too strong to justify an extra-territorial assertion of jurisdiction. International law provides no specific answer, however, for determining what that threshold should be.

Nationality principle

On a basic level, the nationality principle of international law provides that a state may exercise jurisdiction over the activities or conduct of its nationals, wherever they are located, and an individual's nationality is generally determined by citizenship.⁴⁶ Generally, a corporation's nationality is determined either by its country of incorporation or its principal place of business.⁴⁷ Accordingly, the nationality of a parent corporation's foreign subsidiaries and affiliates is that of the foreign state of incorporation or their principal place of business. Generally, the laws of the state of the parent corporation do not regulate the activities of foreign subsidiaries and affiliates that did not operate in the jurisdiction of the regulating state. In the context of economic sanctions, however, a different practice began to develop during World War I and in the late 1930s as the US, the UK and other belligerent countries utilised extra-territorial trade controls to target third country (neutral) trade with enemy states. In particular, the US and UK imposed sanctions on home-state companies whose foreign subsidiaries and branches were trading with enemy states (Domke, 1943). The legal basis for the extra-territorial extension of economic controls to third country entities was an expansive interpretation of the nationality principle that attributed the nationality of a parent company to its controlled foreign subsidiaries and affiliates.

Active and passive nationality principle

In the twentieth century, however, as the international economy has undergone significant growth and integration and the international trading activities of multi-national companies have become a common occurrence, there has been a corresponding need for states to restrict the activities of their nationals in a manner which protects the state's national interest. As a result, many states, such as the US and the UK, have relied on the nationality principle to require that its nationals adhere to its home country laws wherever they reside in the world, unless there is a direct conflict with the laws of the nation in which they reside.⁴⁸ There are two types of jurisdiction

⁴⁶ *Nottebohm Case (Liechtenstein v. Guatemala)*, ICJ Reports, 1955, p. 4.

⁴⁷ *Case concerning Barcelona Traction, Light and Power Co.*, ICJ Reports, 1970, p. 3.

⁴⁸ United Kingdom legislation has conferred jurisdiction extra-territorially over nationals, *inter alia*, in respect of treason, murder, bigamy and breaches of Official Secrets Act. See Brownlie (1990, 300).

by nationality: Active Nationality Principle and Passive Nationality Principle. As stated above, the active nationality principle allows a state to assume jurisdiction over all of its nationals, wherever they may be located. The active nationality principle is generally conceded by international law to all states seeking to apply it. The passive nationality (or Personality) principle authorises a state to assume jurisdiction over an alien for acts committed abroad if such acts caused injury or damages to one of the state's nationals (Mann, 1964, 40–41; Jennings, 1967, 154).⁴⁹

Corporate nationality

The definition of 'corporate nationality' presents particular difficulties because corporations may have substantive connections with several jurisdictions. The International Court of Justice has recognised that as a matter of customary international law the nationality of a corporation belongs to either the state of incorporation or principal place of business.⁵⁰ Although US state practice holds that a corporation normally has the nationality or citizenship of the country where it is incorporated, or where it has its principal place of business, there are statutory exceptions (Fletcher, 1974, ss. 25–26).⁵¹ For example, US sanctions regulations pierce the veil of corporate nationality by imposing US jurisdiction on companies incorporated under the laws of foreign states if the companies are subject to the control of a US person. The major US economic sanctions legislation utilise the nationality principle to impose extra-territorial jurisdiction over US-controlled foreign corporations and business entities.⁵² For example, the International Emergency Economic Powers Act and the Trading with the Enemy Act apply to 'any person, or ... any property, subject to the jurisdiction of the United States.'⁵³ The Office of Foreign Assets Control and the Bureau of Export Administration take the view that these laws apply to non-US corporations that are owned or controlled by US persons.⁵⁴ The

⁴⁹ Moore (1906, ii, 228–242) cites the Cutting case where a Mexican court exercised jurisdiction in respect of the publication in Texas of a defamatory letter by a US newspaper.

⁵⁰ See Barcelona Traction, ICJ Reports, 1970, p. 3.

⁵¹ Nevertheless, the Internal Revenue Code taxes foreign source income of foreign corporations if they are owned or controlled by US citizens, thereby treating those corporations as if they are US nationals for taxation purposes. See Internal Revenue Code, 26 U.S.C. § 903.

⁵² See International Emergency Economic Powers Act (IEEPA), 50 U.S.C. §§1701–1706 (full citation in Chapters 2 and 4). Export Administration Act of 1995, 50 U.S.C. app. 2401 et seq.

⁵³ 50 U.S.C. §1702(a)(1)(a)&(B).

⁵⁴ The OFAC Cuban Regulations state the following:

The term, 'person subject to the jurisdiction of the United States', includes:

(a) Any individual, wherever located, who is a citizen or resident of the United States...

nationality principle provides the basis for the US to restrict the business activities of foreign business entities that are subject to US control with the result that foreign branches or wholly owned affiliates of US parent companies are required to comply with US economic sanctions laws.

It should be emphasised that the US government has often utilised the nationality principle as a basis for the extra-territorial application of US economic regulation and in particular of US economic sanctions. It provides that a state's jurisdiction may reach all its citizens and business entities, wherever they are located, and it combines with the territorial principle to apply to people who travel across national boundaries. It recognises the legal possibility for legitimate and concurrent jurisdiction by more than one nation over the same act when it is undertaken by the nationals of one country within the territory of another. Although most states recognise the nationality principle, they interpret it differently. The US has adopted a broad definition that includes companies which are incorporated outside the US but are controlled by US persons.⁵⁵ By contrast, the UK has held firmly to the traditional view that the nationality of a corporation is determined by its place of incorporation or principal place of business, and may not be determined by the nationality of its controlling shareholders.⁵⁶

Protective principle of jurisdiction

International law permits states to exercise a protective jurisdiction over crimes against its security and integrity or its vital economic interests. The power to enforce such protection is ordinarily found in the criminal codes of most states, and it is generally referred to as the protective principle. The House of Lords recognised the protective principle as part of the English Common Law in *Joyce v. DPP*,⁵⁷ in which it was held that an alien owed some kind of allegiance to the Crown and could be prosecuted in certain situations for treason. The basis of the Lords decision was that criminal jurisdiction could be imposed abroad against an alien who committed certain crimes, such as treason, which were directed against the security and integrity of the realm. The ratio decidendi of the case has been applied to other statutory offences of a similar scope, including, for example, the Official Secrets Act (Brownlie, 1990, 304).

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- (c) Any corporation organized under the laws of the United States or of any state, territory, possession, or district of the United States; and
 - (d) Any corporation, partnership, or association, wherever organized or doing business, that is owned or controlled by persons specified in paragraph (a) or (c) of this section.

31 CFR § 515.329 (a)–(d) (1998).

⁵⁵ See Blumberg (1993b). The concept of control liability is discussed in Chapter 5.

⁵⁶ United Kingdom: Aide Memoire to the Commission of the European Communities, 20 Oct. 1969, in Dyestuffs, reprinted Brownlie (1990, 311–313).

⁵⁷ *Joyce v. D.P.P.* [1946] AC 347.

The rational grounds for the exercise of such jurisdiction are two-fold: (1) that the offences subject to the application of the protective principle are such that their consequences may be of high importance and concern to the state against which they are directed; and (2) unless the jurisdiction were exercised, many such offences would escape punishment altogether because they did not violate the law of the place where they were committed (*lex loci delicti*), or because extradition would be refused by reason of the political character of the offence. Some states and jurists object to the protective principle because it essentially authorises each state to be its own judge as to what is a legitimate threat to its security or economic interests. As a result, the application of the protective principle can be, in many instances, quite arbitrary.

Universal principle of jurisdiction

The universal principle of jurisdiction is based on each state's right to enforce peremptory norms of international law.⁵⁸ Such peremptory norms or fundamental principles are known in international legal parlance as *ius cogens* and include prohibitions against slavery, piracy, unlawful use of force, and certain basic political and social rights enumerated in the international human rights conventions.⁵⁹ When a state has committed an offence against one of its nationals in violation of a peremptory norm of international law, another foreign state may impose universal jurisdiction over the dispute and invoke diplomatic immunity on behalf of the aggrieved individual. The foreign state's right of diplomatic protection derives from the obligation of all states *erga omnes* (to the world community) not to violate peremptory norms of international law, for all states suffer injury as a result of such violations.⁶⁰ By contrast, when an individual suffers as the result of its state's violation of customary international law, but the violation

⁵⁸ It is generally accepted by most jurist that the slave trade, trafficking in narcotics, counterfeiting, and *dicta iuris gentium* and by custom should be treated as piracy, which would be subject to universal jurisdiction by all states. Brownlie, however, makes the distinction between the principle of universality where international law provides an 'auxiliary competence' for a state to punish crimes committed abroad under that state's national law, and universality in respect of breaches of international law, such as war crimes and human rights abuses, that invoke a more limited principle of universality. See Brownlie (1990, 305).

⁵⁹ See Vienna Convention on The Law of Treaties 1969, art. 64 (prohibiting states from contracting out of peremptory norms of international law). See G. Schwarzenberger, 'Jus Cogens and International Law', (1965) 43 *Tex L. Rev.* 456.

⁶⁰ See Barcelona Traction, ICJ Rep. (1970) pp. 4–7. See also discussion in Harris (1998, 604–605). Moreover, the International Law Commission has recognised the obligation *erga omnes* in its 1996 Draft Report when it stated that the ICJ in Barcelona Traction had intended 'to draw a fundamental distinction between international obligations...which by reason of the importance of their subject matter for the international community as a whole, are – unlike the others – obligations in whose

itself does not rise to the level of a breach of a peremptory norm, a foreign state may not invoke diplomatic protection. In the latter case, a state may only assert the claim of an individual if it has a diplomatic link with the aggrieved party.⁶¹

The universal principle allows a state to impose jurisdiction on an offender, regardless of where the offence occurs, for committing an offence which violates a fundamental norm of the international community. Such an offence is treated as a *delicti jure gentium* and all states are entitled to apprehend and punish the offenders. Accordingly, all states are entitled to arrest pirates on the high seas, and to punish them irrespective of nationality, and of the place of commission of the crime. The commission of such offences justifies universal jurisdiction because they threaten not only the state of the national whose rights were infringed but also the basic interests of the international community. Although territory has served as the primary basis for jurisdictional claims, international law has evolved to allow more expansive notions of extra-territorial jurisdiction to regulate persons or events that directly affect the interests and well-being of the nation state.

Extra-territorial jurisdiction and state practice

Although modern state practice has evolved to permit certain extra-territorial approaches to jurisdiction, there remains considerable support for a strict adherence to traditional principles of territorial jurisdiction. Indeed, this is true in the area of extra-territorial economic sanctions where state practice has coalesced around two approaches: (1) the traditional territorial approach that restricts the imposition of liability under economic sanctions to those persons and entities who operate or are registered in the sanctioning state; and (2) an extra-territorial approach to jurisdiction that relies on the effects doctrine and a broad application of the nationality principle. The strongest advocates of the territorial approach are the United Kingdom,⁶² Japan and Australia, while extra-territorial approaches using either the effects doctrine or the nationality principle as a jurisdictional

fulfillment all States have a legal interest." See I.L.C. 1996 Draft Report, G.A.O.R., 51st sess., Supp. 10, p. 125.

⁶¹ See *Nottebohm Case*, (Lichenstein v. Guatemala) ICJ Rep., (1955) p. 4.

⁶² It is important to note, however, that British criminal law has become more expansive in imposing extra-territorial jurisdiction in recent years. Section 102(1) of the Criminal Justice Act 1988 states:

"'Criminal conduct' means conduct which constitutes an offence to which this part of this Act applies or would constitute such an offence if it had occurred in England and Wales or Scotland."

Section 93A of the Criminal Justice Act 1993 recodifies this provision and applies it in the case of money laundering.

basis have been embraced by Canada,⁶³ France, Germany⁶⁴ and the US (Meessen, 1992, 8–10).⁶⁵

Regarding US extra-territorial sanctions, contentious debates have surrounded their interaction with European regulatory controls. US sanctions often apply extra-territorially to foreign businesses, investors and to some foreign persons who hold or manage abroad US dollar assets, while European sanctions laws are much more territorial in their application, as they focus mainly on targeted states and their nationals, and not as much on foreign businesses and investors in third countries. Extra-territorial US sanctions pose a problem for Britain and Europe. A number of US sanctions programmes apply extra-territorially to the business activities of UK and European businesses. For instance, the Cuban trade embargo creates potential civil liability for UK nationals and firms who do business with Cuba. Similarly, the US Iran Transaction regulations create the risk of civil and criminal liability for European banks that provide financial assistance in Europe to the Iranian government or Iranian nationals. Moreover, the US Treasury has unilaterally blocked the assets of US-designated terrorists who

⁶³ Indeed, the Canadian Constitution imposes no territorial limits on federal legislative jurisdiction. This derives from section 3 of the Statute of Westminster that grants Dominion Parliaments the power to adopt legislation with extra-territorial effect. See Statute of Westminster, 1931, 22 Geo. 5, ch. 4, § 3 (stating '[I]t is hereby declared and enacted that the Parliament of a Dominion has full power to make laws having extra-territorial operation').

⁶⁴ The German Supreme Court has similarly defined the parameters of extra-territorial jurisdiction in competition law cases. See *Oil Pipelines case*, Decision of July 12 1973, 25 BGHSt 208; and *Organic Pigments case*, Decision of May 29 1979, 74BGHZ 322.

⁶⁵ Similarly, based on the competition law principles of Article 81 (ex-Art. 85) of the Treaty of Rome, the European Commission has expressly adopted the effects doctrine as a tool of regulatory enforcement to impose extra-territorial jurisdiction against anti-competitive practices outside the EU which impact Community markets. The Federal Republic of Germany codified the effects doctrine in its competition law. See *Gesetz gegen Wettbewerbsbeschränkungen (GWB)*, § 98(2) ('Act against Restraints on Competition'). Although the European Court of Justice (ECJ) upheld the Commission's use of such extra-territorial measures to enforce EC competition law, it has refused to recognise the effects doctrine as the legal basis for its decisions. *Case 89/85, Ahlstrom Asakeytio et autres v. Commission des Communautés Europeennes* [1988] E.C.R. 5193, 4 C.M.L.R. 901 ('*In re Wood Pulp Cartel*'). *In re Wood Pulp Cartel* involved a violation of Article 81 where the European Commission found that several entirely foreign companies, including a US firm, conspired to fix prices in violation of Article 81. See *In re Pulp Wood cases* [1988] E.C.R. 5196–5198. Moreover, the ECJ has accepted the economic control principle (otherwise known as the unity of the enterprise doctrine) as the legal basis for imposing extra-territorial jurisdiction on anti-competitive acts outside the EU that impact EC markets. *I.C. Industries, Ltd. v. EEC Commission* [1972] E.C.R. 619 (applying the unity of the enterprise theory); see also, *Europemballage Corp. v. E.C. Comm'n* [1973] E.C.R. 215.

live and work in the United Kingdom and other EU states. These constitute conflicts of public regulatory law that will be addressed in chapter 8.

Extra-territorial jurisdiction and export controls

In the area of export controls, state practice appears to have settled on some substantive standards; for example, it is generally accepted that a state's attempt to enforce its economic sanctions laws in the territory of a foreign state violates the principle of state sovereignty (Kelsen, 1948, 209). By contrast, other techniques of extra-territoriality are accepted to the extent that they regulate or penalise a course of conduct that presents an effective and significant connection with the forum state (Meessen, 1992, 8). Naturally, however, there are factual scenarios that give rise to extra-territoriality disputes. For instance, in principle, non-resident citizens can be subjected to the jurisdiction of their national state; however, when the state of residence imposes commands which conflict with the state of nationality, the state of residence will likely prevail (Mann, 1984, 30). The justification for the state of residency having priority is that ordinarily it will have actual control over the persons residing within its territory, in which case there will be a presumption that enforcement action is more likely to be taken by the state of residence.⁶⁶ The state of residence can ensure compliance with its commands by coercive means and thereby pose greater detriment to the resident alien.⁶⁷ Therefore, international comity would suggest that a national state's power to exercise jurisdiction over its non-resident citizens should yield to the concurrent power of their state of residence.⁶⁸

Similarly, the imposition of economic sanctions against foreign subsidiaries of domestic parent companies has also raised significant issues

⁶⁶ US courts have extended this principle to include non-residents of the US who are served while temporarily present in the US with a subpoena to testify before a US grand jury investigating tax law violations notwithstanding the testimony would violate the laws of the non-resident's home jurisdiction. See *In re Grand Jury Proceedings, United States v. Field*, 532 F. 2d 404, 410 (5th Cir., 1975).

⁶⁷ US courts and regulators have taken this position. See *In re Grand Jury Proceedings, United States v. Bank of Nova Scotia*, 691 F. 2d 1384 (11th Cir. 1982) (presence of Miami branch of Canadian bank in US permitted US authorities to compel branch to provide financial information about bank's Bahamian branch despite Bahamian bank secrecy law's forbidding disclosure of such information); *In re Grand Jury Proceedings, United States v. Bank of Nova Scotia (Bank of Nova Scotia II)*, 740 F. 2d 817 (11th Cir. 1984) (sanctions could be imposed on Miami branch of Canadian bank for failing to comply with subpoena of US grand jury to produce financial records located in the Cayman Islands when production would violate Cayman bank secrecy law).

⁶⁸ US courts and economic regulators reject this approach. See *United States v. Noriega*, 1990 WL 142524 (SD Fla.); *In the Matter of Dominick & Dominick, Inc. and Werner Ulrich*, 48 SEC Docket 1544, Rel. No. 29243 (1991).

of concurrent claims to jurisdiction by competing states.⁶⁹ Traditionally, foreign subsidiaries doing business abroad are considered separate legal entities and as such are entitled to be qualified as foreign companies provided that they are incorporated in the foreign state in which they operate or have their registered offices.⁷⁰ As a legal matter, therefore, the conduct of a company was regulated by the state of incorporation and the state where the company did business.⁷¹ No significance was attached to other criteria such as ownership or economic and political control.⁷² This rather formalistic method for determining which state has the jurisdictional authority to regulate the activities of companies or entities has failed to take account of the complex nature of the modern multi-national enterprise where ownership, management and workforces have become increasingly global. As such, this approach is not particularly well suited to evaluate which states have a legitimate enough link with a particular company to justify the imposition of regulatory jurisdiction.⁷³

As a result, the EC and US economic regulatory regimes have responded to these formalistic constraints on national economic regulation by adopting sophisticated techniques using various legal criteria to evaluate corporate affiliation and agency relationships for jurisdictional purposes. Such criteria are responses to the increasing complexity of the global marketplace in which the nature of international business transactions has been fundamentally changed, in part, by advances in technology. Indeed, the International Court of Justice in *Barcelona Traction* recognised the possibility that other legal criteria, derived from the world's leading legal systems might gain general consensus so that 'sometimes links to one State have to be weighed against those of another'. Such newly emerging techniques and criteria might be applied as generally recognised principles of law for determining extra-territorial jurisdiction in an increasingly complex global

⁶⁹ See so-called 'John Doe' subpoenas used by US authorities in money laundering, terrorist finance and tax investigations which can be issued to a US parent company to compel all its subsidiaries (domestic and foreign) to provide 'all records' within their possession. *In re the Matter of Tax Liabilities: John Does* (1991) No. C-IV88-0317 Misc (No District CA 1992) (upheld possible civil and criminal liability against US person even though it would require unlawful acts by foreign subsidiary in its jurisdiction)

⁷⁰ See position of European Commission in *In re Pulp Wood Cartel cases*, at 5193.

⁷¹ See case concerning the *Barcelona Traction, Light, and Power Co., Ltd.* (*Belgium v. Spain*) Second Phase, ICJ Reports, 1970, p. 3, 48.

⁷² The ICJ ruled in *Barcelona Traction* that the only admissible legal basis for attributing nationality to a corporation for purposes of diplomatic protection was the company's state of incorporation or place of operation, and not the jurisdiction of the place of the shareholders.

⁷³ See Blumberg (1993, 43-48) discussing changing legal structures of multi-national enterprises, compare with Caves (1982, 26).

marketplace.⁷⁴ Yet, at this stage of development, there is still resistance in state practice to these emerging standards of extra-territorial jurisdiction for regulating multi-national enterprises.

US state practice, however, seeks to regulate events and affairs that occur solely outside US territory through its regulatory control over multi-national enterprises and financial firms that are involved in US-connected commerce. In criminal law, US export control law imposes liability on third country nationals and corporate entities who conspire to circumvent US export controls.⁷⁵ In such conspiracy cases, third country states have been more willing to accept the application of extra-territorial measures when it can be adequately proved that their nationals had wilfully intended to violate US export controls.⁷⁶ In these cases, the locus delicti is not considered a decisive factor, and whether the conspiracy has occurred, in whole or part, in the regulating state's territory does not appear to be a crucial issue (Bianchi, 1992, 366–374). Moreover, in such cases, US law places the burden of proof on the US government to demonstrate that such a conspiracy to circumvent US controls has occurred.⁷⁷

US jurisdiction over foreign persons who re-export US-origin products and technology

There has been much conflict over whether a state can assert a unilateral claim of jurisdiction over exported goods or technical data on the basis of the national origin of such goods (Kuijper, 1984, 81–84). Such extra-territorial claims, often asserted by the US government, have been firmly and consistently rejected by other major states.⁷⁸ The US government has argued that the nationality principle of international law ought to attach to goods and technologies which are exported by a state.⁷⁹ The Export Administration Act puts

⁷⁴ Barcelona Traction, ICJ Reports p. 42.

⁷⁵ See 18 U.S.C. sec. 2 (2006). The US Bureau of Industry Affairs has adopted this view in enforcing the Export Administration Regulations. See 15 CFR. § 770.2 (2006).

⁷⁶ See Brownlie (1990, 314) citing 'Statement of Principles According To Which, In the View of The United Kingdom Government, Jurisdiction May Be Exercised Over Foreign Corporations In Anti-Trust Matters' Aide Memoire (20 Oct. 1969).

⁷⁷ Determinations by the US Bureau of Industry and Security (BIS) are also subject to judicial review by the Federal Circuit Court of Appeals for the District of Columbia. See The Omnibus Trade and Competitiveness Act, Pub. L. 100–418, 102 Stat. 1107, codified at 15 U.S.C. §2428(a)(1); also reproduced in 28 ILM 399 (1989).

⁷⁸ See discussion of issues in Serbian Pipeline Affair at 21 ILM 891–904 (1982); (unequivocal rejection by European states of the nationality principle as applied to goods and technology).

⁷⁹ A. Q. Connaughton, Lecture and Interview, Office of Chief Counsel, Bureau of Export Administration (6 Nov. 1997). The re-export restrictions apply equally to US technical data, which could take the form of information, tangible or intangible, which can be used in the design, production or manufacture of products. 15 C.F.R.

this view into practice by imposing strict controls on re-exports of US-origin products and technology by third country nationals to targeted states and entities.⁸⁰ Other states reject this practice as a violation of international law on the grounds that once these goods reach the dominion of another state such goods and technical data are assumed to have come under its jurisdiction.⁸¹ At that point, it is argued, the exporting state can no longer claim control over such products, unless the international responsibility of the importing state as the state of final destination of the goods has been engaged by treaty or other international pledge. Accordingly, re-exports can be controlled by the original exporting state only with the consent of the original importing state.

The US government contends however that such re-export controls are legal under international law because of the contractual acceptance of re-export controls by the customs officers of the importing state when they sign an 'end-use certificate' or the IC/DV (Import Certificate/Delivery Verification) form (Connaughton, 1997). This acceptance triggers the international responsibility of the importing state, provided that such relevant documents certifying the importing state as the state of final destination have been signed by state officials. In this respect, the exporting state's grant of an export licence and the importing state's signing of the 'end-use certificate' or other similar documents as such qualify as an agreement in which the importing state has been granted the privilege to import the products or technology on the condition that such goods not be used for prohibited purposes, such as being re-exported to targeted states or their

secs. 374.1, 379.8. This prohibition on re-exports also applies to third country nationals who seek to export products manufactured wholly in a third country, but which contain no US components or materials but are based on US-origin technical data. *Ibid.* secs 779.1, 779.4, 779.8.

⁸⁰ The Export Administration Regulations ('EARs') prohibit a corporation or other business entity organised under the laws of a third country and located and doing business in that country from exporting to Cuba products manufactured wholly in that third country, but which incorporate any US component parts or materials. 15 C.F.R. sec. 374.2 (2004). This is so regardless of whether component parts or materials have been completely transformed in the new product. Exceptions are possible only upon application for a validated licence by the third country company that demonstrates that the US-origin component parts or materials constitute 20 per cent or less of the value of the product. 15 C.F.R. sec. 376.12 (2004). If US content is less than 10 per cent, the product may be exported without obtaining a validated licence. See 15 C.F.R. secs 774.1, 776.12, 785.1 (2004).

⁸¹ *American President Lines Ltd. v. China Mutual Trading Co. Ltd*, Supreme Court of Hong Kong, (1953) Am. Mar. Cases 1510; see also, *Moens v. Mankiewicz and Hamburg-American Line*, Comm. Trib. Of Antwerp, cit. in 30 *Rechtskundig Weekblad* 1966–67, kol. 360–363, and also cited in Comment: 'Western European Sovereignty and American Export and Trade Controls', (1970) 9 *Colum. J. Transnat'l L.* 109–139, 115.

nationals. As a result, the importing state, by signing the trade documents, has at least tolerated the extra-territorial assertion of jurisdiction over the exported goods or technology and has at most adopted the policy aims of the exporting state by allowing its customs officials to sign the relevant documents (Marcus and Richard, 1981, 478).

Moreover, extra-territorial controls may still apply, even though a purchaser has executed a purchase of US goods without agreeing to such a stipulation. This occurred in 1982 when President Reagan imposed export controls on the use of US-origin oil and gas equipment by European firms in the construction of the Soviet gas pipeline (Kuijper, 1984, 84–87). One of the legal bases for imposing such controls on US-controlled European firms was the nationality principle of jurisdiction. Regarding European firms that were not US controlled, extra-territorial jurisdiction was based on the use by those firms of US-licensed technology in the product or service that was being sold to the Soviet Union. More controversially, these controls were given retroactive effect, thus requiring European firms to cancel their obligations under executory contracts with other firms that were doing work on the pipeline. The US viewed the retroactivity of the controls to be justified because all validated US export licences contain language that puts the foreign importer on notice that the exported product or technology in question may become subject to re-export controls in the future if the president determines that to do so would be in the national interests (Mabry and Moyer, 1982, 107).

Many EC states reject this position because they view such reserve powers in a contractual agreement to be an abuse of the freedom to contract and to be an intrusion upon the legislative competency of the state where the goods or services were exported (Kuijper, 1984, 84–87). After a diplomatic furore had been created between the US and its major trading partners over the extra-territorial nature of such controls, the US rescinded them in late 1982, and construction on the Soviet pipeline continued. Presently, US law generally prohibits the president from imposing such controls if they result in the cancellation of pre-existing contractual obligations, but there is an exception where the president certifies to Congress that a breach of the peace exists, which poses a serious threat to the strategic interests of the US, and that the export control in question is necessary to accomplish US objectives and will be withdrawn once the threat ceases.⁸²

As will be discussed in Chapter 11, the efforts of international organisations, multilateral bodies and the European Union to regulate and interdict the financing of terrorist activity have had an important impact in developing public international law in this area. Specifically, the United Nations and Financial Action Task Force have taken the lead at the international level in setting international standards that require states to

⁸² 50 U.S.C. App. § 2405(m) (Supp. V 1987).

expand the jurisdictional scope of their regulations, especially in financial markets, to control and interdict the financing of terrorist activities. In addition, the European Union adopted Regulations that expand the list of designated terrorist groups and requires EU member states to prohibit commercial or financial transactions with persons or entities that provide support for, or are involved with, designated terrorist groups.⁸³ These international and regional efforts have facilitated a great deal of bilateral and multilateral co-operation amongst countries that has resulted in a more effective global approach for the freezing of terrorist assets that are located in the formal banking and financial sectors of multiple jurisdictions. Although international standard setting in this area is an essential component in devising an effective international regime to interdict terrorist financing, Chapter 11 will argue that an effective anti-terrorist financing regime depends less on adopting uniform international approaches and more on differential regulatory practices that are based on the unique characteristics of a country's economic and financial system.

Conclusion

International law provides an important framework for the development of effective and legitimate economic sanctions. International law provides an institutional basis and principles – based framework for reviewing and monitoring the use of economic sanctions. State practice in economic sanctions is governed by the legal principles of retorsion and reprisals. A sanctions measure can be in retorsion if it does not violate a legal duty to another state or to the international community. In contrast, a sanctions measure that breaches a duty to the targeted state is a countermeasure. For a countermeasure to be lawful under international law, it must be reciprocal and proportional in its aim and application.

The chapter also addressed the jurisdictional issues that arise for a state in devising an economic sanctions programme. A strict adherence either to a narrow concept of territoriality or a more expansive concept of the effects doctrine or nationality principle may not provide practitioners and judges with a reliable starting point for determining generally accepted international standards for resolving disputes over concurrent claims of jurisdiction by two or more states. The tendency of modern jurists to apply the principle of extra-territorial jurisdiction espoused by the PCIJ in the *Lotus* case has been widely criticised because the case concerned a very specific issue, namely, the exercise of criminal jurisdiction over cases concerning collisions of ships at sea. The main criticism of the *Lotus* doctrine is that traditional concepts for determining domestic jurisdiction – that is,

⁸³ See EU Regulation 467/2001.

territoriality and nationality – depend for their validity on the supremacy of the doctrine of sovereignty of states in the international legal system. Although the role of sovereignty remains an important doctrine of international law, it has undergone major changes in recent years as territorial boundaries have been made less relevant due to the dramatic changes in technology and international commerce which are sweeping the global economy. As a result, notions of domestic jurisdiction, so closely intertwined with the concept of sovereignty, are changing as well and have led to the emergence of what some scholars have called ‘transnational solidarities’.⁸⁴ By the latter expression, one must refer to a set of values and interests, common to each and every state, which are perceived as shared concerns by the international community as a whole. The interpretation and enforcement of such values and interests, however, will almost always depend on the national interests of the regulating state, and may often result in states using extra-territorial measures to promote such interests.

These jurisdictional clashes between states mean that states should work through multilateral institutions to agree on general approaches to extra-territorial jurisdiction. Even where there is an international consensus regarding how sanctions should be imposed, the experience of the United Nations has shown that multilateral sanctions are likely to fail if states lack the political will to enforce them and do not tailor the design of sanctions to take account of the state’s unique economic and institutional circumstances. The efficacy of a state’s economic sanctions programme therefore will depend on a combination of political willingness, economic capacity, and consistency in the application of legal principles.

⁸⁴ See Note, *Constructing the State Extra-territorially: Jurisdictional Discourse, the National Interest, and Transnational Norms*, (1990) *Harv. L. Rev.*

4

Economic Sanctions and State Practice

In modern history, sanctions do not help resolve conflicts. Many countries do not want sanctions imposed on Iran. A number of European countries, Russia and China do not support this.

Sergei Lavrov, Russian Foreign Minister,
15 February 2006

Introduction

Modern economic sanctions policy and regulation has been developed mainly by the world's leading developed countries. Most of these countries have sophisticated market economies that expanded dramatically in the twentieth century based in part on high levels of international trade and foreign investment. The financial systems of these countries have provided a reservoir of capital and investment skills that have transformed today's globalised financial markets (Kono and Schuknecht, 2000, 144–146). As discussed in Chapter 2, much of the economic growth in these countries has depended on high levels of cross-border trade, investment and portfolio capital flows. These developed industrialised economies compose the core economies of the global economic system, while smaller developed countries and most developing and emerging market countries constitute peripheral economies that are heavily dependent on the core economies for investment capital and international trade in goods and services. The states of the core economies have legal and regulatory regimes that allow policymakers to withhold benefits or impose restrictions on investment and trade with their economies in order to promote non-economic foreign policy objectives. The size and scale of these economies and the growing liberalisation of cross-border financial flows and international trade in goods and services have enabled these states to increase their political influence internationally by extending the application of their economic sanctions measures to more targeted areas of the global economy.

The chapter will examine the economic sanctions practice of leading developed countries by examining their regulatory and legal frameworks and the policy objectives which inform their use. The sanctions programmes of some core economy states, such as the US, the UK and Japan, will be examined to show the different institutional, legal and regulatory approaches to sanctions practice. The European Union economic sanctions framework will be analysed along with the principles that guide their application. Particular emphasis will be placed on the UK economic sanctions regime against Southern Rhodesia because it was the most comprehensive and the longest UK sanctions policy since World War II. The problems confronting UN sanctions programmes will be discussed by analysing the cases of Southern Rhodesia and Libya to show some of the legal and regulatory gaps that can undermine the effectiveness of a multilateral sanctions regime. The UN sanctions regime against Iraq has been analysed in great detail in recent literature and will only be alluded to in this chapter to demonstrate the potential effectiveness of multilateral sanctions. The chapter's overall goal is to outline the development of some of the major national sanctions regimes and to analyse their main institutional and legal dimensions. The chapter suggests that an effective sanctions regime must be based on clearly defined objectives which can be measured and monitored and an explicit set of conditions or circumstances to show when sanctions should be modified or lifted.

I United States economic sanctions

Since 1945 the major nations of the world have used economic sanctions in a variety of contexts in pursuit of their diplomatic and national security objectives. According to Schott, Hufbauer and Elliot's widely cited 1990 study (1990, 4–14, 163–283), nations imposed economic sanctions in at least ninety one cases between 1945 and 1990. Of this total, the US applied economic sanctions, either alone or in conjunction with other states, on more occasions than all other countries combined. Since 1991, the US government has dramatically increased its use of economic sanctions, specifically targeting countries which, *inter alia*, support international terrorism, the manufacture of weapons of mass destruction, the abuse of political and civil rights, money laundering and drug trafficking, and confiscation of US-owned property.¹ The increased use of economic sanctions by the US government

¹ Specifically, the purpose of US economic sanctions against Cuba has been to provide compensation for former US owners of confiscated property in Cuba, to deter Cuba from engaging in state-sponsored terrorism, and to force Cuba to adopt democratic reforms. See Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1996, Pub. L. No. 104–114, 110 Stat. 785 (codified at 22 U.S.C. s.6021 [2006]); see also Cuban Democracy Act of 1992, Pub. L. No. 102–484, s. 1704, 106 Stat. 2576 (1992) (codified at 22 U.S.C. s. 6003 [2006]). Similarly, the purpose of US sanctions against Iran and Libya has been to deter their support for international terrorism and the

can be attributed in part to the relative increase in its economic and military influence in the post-cold war era and to the liberalisation of the global economy that has allowed US regulatory practices to cover many areas of international trade, commerce and finance. Similarly, other leading developed countries – for example, Japan and the UK – have exploited their significant positions in the global economy and financial system by increasing their use of economic sanctions both unilaterally and through regional and multilateral arrangements.

US unilateral sanctions

The United States has responded to the demise of the Soviet Union in the post-Cold War era by becoming more assertive in promoting its foreign policy and national security objectives. In doing so, it has utilised a combination of foreign policy instruments that include military force, economic restrictions and export controls to support a more assertive diplomacy in pursuing its national interests. For instance, US policymakers have justified extra-territorial economic restrictions on foreign businesses in order to pressure foreign states to adhere to certain norms and standards of economic and regulatory practice that serve US interests.² Assuming the realist perspective of international relations theory, the US government has not hesitated to use its economic power to increase pressure on certain states to comply with both international law and emerging standards of normative regimes in an effort to promote stability and maintain its hegemonic position within the international system. Specifically, the United States in recent years has increased and broadened the scope of economic sanctions against Cuba, Iran and North Korea because these states have consistently adhered to policies which, according to the US, threaten US security interests and violate international law.³

development of weapons of mass destruction. See Iran Libya Sanctions Act of 1996, Pub. L. No. 104–172, 110 Stat. 1541 (codified at 50 U.S.C. s. 1701 [2006]). In 1994, the US imposed technology and economic aid restrictions against India and Pakistan because of their detonation of nuclear devices. See Nuclear Proliferation Prevention Act of 1994 (NPPA), 22 U.S.C. s. 3201 (1994)(amending the Arms Export Control Act by adding language that, *inter alia*, mandates a menu of sanctions against any ‘non-nuclear’ state that ‘detonated a nuclear explosive device on May 11, 1998’). See 22 U.S.C. secs. 2751–2796d (2004). In 2006, the US amended its legislation lifting most of these sanctions as they applied against India when it entered an agreement allowing India to develop its uranium enrichment programme for civilian nuclear reactors.

² For instance, the unilateral and extra-territorial application of the US Foreign Corrupt Practices Act has catalysed the member states of the Organisation for Economic Cooperation and Development to adopt comprehensive measures to reduce bribery and corruption of government officials. See J. Wallace, *Amicus Curiae* (October, 2000).

³ See Cuban Democracy Act of 1992, Pub. L. 102–484, 106 Stat. 2575, *incorporated into* Title I of the Cuban Liberty and Democratic Solidarity Act (LIBERTAD),

To accomplish this, the US has increased the scope and degree of extra-territorial sanctions against third country business entities which trade or invest with states deemed by the US as having committed fundamental breaches of international law and threaten the stability of the international system.⁴ Moreover, the US government has imposed foreign assets control regulations against international terrorists and narcotics traffickers that have extra-territorial effect against third country persons, such as financial intermediaries and corporate groups, who do business or facilitate transactions with these targeted entities.⁵ The use of such sanctions has been harshly criticised within the international community as a violation of international law (Marcus, 1996, 9),⁶ but US economic and foreign policymakers justify the increased use of extra-territorial economic and financial sanctions on the grounds that markets are more globalised and liberalised today, and advances in technology allow US markets to be affected by practices that take place in foreign jurisdictions, and that the US should use access to its large market as an incentive to pressure foreign

Pub. L. 104–114, 110 Stat. 785, (enacted 12 March 1996), *codified at* 22 U.S.C. §§6021–6091; Iran and Libya Sanctions Act of 1996, Pub. L. 104–172, 110 Stat. 1541, 1542 (enacted 5 Aug. 1996), 35 I.L.M. 577 (1996). For policy rationales for imposing extra-territorial US sanctions, see Helms (1999, 2–5). The foremost legislative proponent of US sanctions was former US Senator Jesse Helms, who as Chairman of the United States Senate Foreign Relations Committee in the 1990s had argued that there are ‘three tools in foreign policy: diplomacy, sanctions, and war. Take away sanctions and how can the United States deal with terrorists, proliferators, and genocidal dictators? Our options would be empty talk or sending in the marines. Without sanctions, the United States would be virtually powerless to influence events absent war. Sanctions may not be perfect and they are not always the answer, but they are often the only weapon’ (Ibid., 5).

⁴ See the 1994 International Narcotics Control Corrections Act, 22 U.S.C. §2291j (2004) (terminating Export-Import bank assistance to designated states which fail to take effective measures to combat narcotics trafficking and money laundering); the 1996 Anti-Terrorism and Effective Death Penalty Act, 18 U.S.C. §23339B (2004) (a criminal offence for US persons to engage in financial transactions with the governments of countries designated by Secretary of State under §6(j) of Export Administration Act of 1979 as state sponsors of terrorism); and the 1996 Iran/Libya Sanctions Act 50 U.S.C. §1701 *et al.*; imposing sanctions on third country persons who invest in Iran or Libya in an effort to reduce international terrorism).

⁵ See Terrorism Sanctions Regulations, 31 C.F.R. §595 *et seq.* (2006); Foreign Terrorist Organizations Sanctions, 31 C.F.R. §597 *et seq.* (2006); Terrorism List Government Sanctions Regulations, 31 C.F.R. §596 *et seq.* (2006). Statutory authority for these embargo regulations are: Trading With The Enemy Act of 1917 (TWEA), *codified at* 50 App. U.S.C. §§1–44 (2006) and the International Emergency Economic Powers Act of 1977 (IEEPA), 50 U.S.C. §§1701–1706 (2006).

⁶ See Toulon (1996, 5) For European Union response, see Council Regulation (EC) No. 2271/96, Protecting Against The Effects Of The Extra-Territorial Application Of Legislation Adopted By A Third Country, 22 Nov. 1996, 36 *ILM* 125 (1997).

traders and investors not to do business with targeted states, terrorists and economic criminals.

The use of US economic sanctions is governed today by statute and regulation, even though the legal origins for imposing sanctions under US law derived from common law principles.⁷ Under the US Constitution, Congress is vested with the power to regulate trade between the several states and with foreign countries and to enact any laws to carry out its authority.⁸ Traditionally, though Congress retains authority to enact and modify economic sanctions laws, it has generally delegated the power and discretion to impose economic sanctions to the president as commander in-chief to make decisions as to when the use of economic sanctions is warranted to promote the national interests. This congressional policy is demonstrated by the three most important US economic sanctions statutes: Trading With the Enemy Act of 1917 (TWEA),⁹ the International Emergency Economic Powers Act of 1977 (IEEPA),¹⁰ and the Export Administration Act.¹¹ Together, these three statutes provide the main legal basis for the most comprehensive economic sanctions regime in modern history.

Trading With the Enemy Act

The Trading With the Enemy Act (TWEA) was enacted in 1917 after America's entry into World War I, and has served as statutory authority for the President to impose embargoes and financial and economic sanctions during periods of war or declared national emergency against targeted states and entities. Since its inception, the TWEA was intended to block or freeze property or transactions with respect to specific targeted countries. It was first applied during wartime and then later during declared national emergencies when America was not at war. Section 5(b) of the Act was intended to delegate broad discretionary powers to the president during times of war to 'define, regulate, and punish trading with the enemy'. These powers included the regulation of foreign exchange, transactions in gold and silver, and transfers of credit or evidences of indebtedness or property 'between the United States and any foreign country, whether enemy, ally of enemy or otherwise, or

⁷ *The Hoop*, 1 C. Rob. (1799) 196, 199; see also, *Kershaw v. Kelsey*, 97 U.S. 124, 127–128 (1869).

⁸ U.S. Const. art. I, sec. 7(3).

⁹ Trading With The Enemy Act (1917, as amended 28 Dec. 1977), Pub. L. 95–223, Title I, §§101(a), 102, 103(b), 91 Stat. 1625, 1626, codified at 50 U.S.C. §§1–5 (2006) original citation, Act Oct. 6, 1917, C. 106, 40 Stat. 411.

¹⁰ International Emergency Economic Powers Act, Pub. L. 95–223, 91 Stat. 1628, codified at 50 U.S.C. §§1701 et seq. (2006).

¹¹ 50 U.S.C. §§2401–2420 (2006).

between residents of one or more foreign countries'¹² Moreover, the president had authority to nullify pre-existing contractual obligations if such transactions involved enemy states and/or property owned or controlled by enemy states or their nationals. However, all transactions which were to be 'executed wholly within the United States' were exempt from the Act.¹³

When the TWEA was enacted, it contained no authorisation permitting the president to use these broad powers during periods of national emergency when the country was not in a declared war. Nevertheless, at the height of the Great Depression in 1933, President Roosevelt invoked emergency powers under section 5(b) of the TWEA to order a bank holiday.¹⁴ Shortly thereafter, Congress convened and ratified the president's action retroactively by enacting the Emergency Banking Act¹⁵ and by amending section 5(b) to provide the president with the unilateral authority to invoke its emergency powers during peacetime.¹⁶ This was significant because it gave the president power to declare a state of national emergency during peacetime and use the broad powers of the TWEA to impose economic sanctions and other measures against targeted states and entities.

The next major use of the TWEA occurred in April of 1940 when in response to Nazi Germany's invasion of Norway and Denmark, President Roosevelt invoked section 5(b) to issue an order that prohibited all transfers of property in which the governments of Norway or Denmark, or any of their nationals, had an interest.¹⁷ The rationale for these measures was to prevent Norwegian and Danish government officials and nationals from being compelled to transfer their property to German authorities.¹⁸ The

¹² TWEA, §5 (b), 40 Stat. 411, 414 (1917), *reprinted in* Legislative and Executive Documents, 45–48.

¹³ TWEA, Chap. 106, 40 Stat. 411 (1917). In 1921, the US government enacted a law which terminated certain wartime powers of the president, but it explicitly exempted the TWEA because of the substantial amount of alien property which was seized by the allies at the end of World War I that was still being administered by the US government. 41 Stat. 1359 (1921), *codified at* 50 U.S.C. §33.

¹⁴ Proclamation No. 2039, 48 Stat. 1689 (1933).

¹⁵ Emergency Banking and Bank Conservation Act of 1933, ch. I, §1, 48 Stat. 1, 1 *codified at* 12 U.S.C. §95b (1988).

¹⁶ *Ibid.*, ch. I, §2, 48 Stat. 1–2.

¹⁷ Exec. Ord. 8389 (10 Apr. 1940).

¹⁸ *Von Clemm v. Smith*, 255 F.Supp. 353, 368 (S.D.N.Y. 1965)(describing foreign policy objectives of FDR in early stages of war and the use of the TWEA). On 7 May 1940, Congress ratified the president's order and the Treasury's regulations by amending section 5(b) to expand the powers of the president and reaffirming their use during any other period of declared national emergency and with extra-territorial effect. The Alien Property Trustee was given authority to vest all property that was owned or controlled by enemy states or their nationals and business entities. To see how these blocking orders were applied to the US-owned shares of a German corporation, see *Bonnar et.al. v. The United States*, 438 F.2d 540, 548–553 (2nd Cir. 1971).

Treasury Department gave broad application to the President's order by adopting the Foreign Funds Control Regulations that prohibited, except under licences issued by the Secretary of Treasury, transactions in foreign exchange involving the property of Norway or Denmark or any of their nationals after those countries were invaded by Germany in World War II. The Treasury Department also adopted rules that required all US persons and their US-controlled overseas branches or subsidiaries to block all property or interests in property that they held or controlled in foreign jurisdictions on behalf of Norway or Denmark.¹⁹ After these regulations went into effect, Congress adopted a joint resolution on 7 May 1940 that expressed approval of the president's broad exercise of powers in adopting the Foreign Funds Control Regulations.²⁰

President Roosevelt issued several more orders in 1941–42 expanding his authority to freeze assets within US jurisdiction that were controlled by countries occupied by the axis powers.²¹ The Foreign Funds Control Regulations were used during World War II in a manner that was similar to how the US Treasury would later use the foreign assets control regulations against targeted states during the cold war. Thus, while it appeared that Congress had initially intended the TWEA's authority to be primarily concerned with controlling or freezing assets within US territorial jurisdiction held by enemy aliens, the heightened international crisis of the late 1930s and then US entry into World War II led Congress to acquiesce in the executive branch's extra-territorial use of the TWEA as an instrument of economic warfare to regulate property located in foreign jurisdictions that was connected to US commerce.

The next use of section 5(b) of the TWEA occurred in December 1950 during the Korean conflict when President Truman declared a state of national emergency and delegated broad powers to the Secretary of Treasury to impose financial and commercial controls against the Peoples Republic of China and North Korea.²² Truman's declaration was especially significant

¹⁹ See discussion in *United States v. Wagman*, 168 F. Supp. 248, 249–250 (S.D.N.Y. 1958).

²⁰ Section 2 of the Joint Resolution provided: 'Executive Order 8389 of April 10, 1940, and the regulations and general rulings issued thereunder by the Secretary of the Treasury are hereby approved and confirmed'.

²¹ The President's authority to issue these orders imposing comprehensive trade embargoes and freeze orders against property that was owned or controlled by all enemy countries (including invaded countries) and their nationals derived from congressional statute. See Act of 2 July 1940, §6, 54 Stat. 714 (1940), *codified at* 50 U.S.C. §701, *as amended and repealed at* Act of 10 Aug. 1956, §53, 70A Stat. 641 (1956). Similarly, throughout the war, the Department of Commerce administered an array of export control regulations that also included various financial and trade restrictions. See Treasury Dept. General Ruling No. 11, 7 Fed. Reg. 2168 (1942).

²² Pres. Proclamation No. 2914, 16 December 1950, 15 Fed. Reg. 9092 (1950), 3 C.F.R. §99 (1950), *reprinted in* Sen. Special Comm. on the Termination of the National Emergency, *Emergency Powers Statutes: Provisions of Federal Law Now in Effect*

because it remained in effect over the next 25 years and provided the legal basis for subsequent presidents to impose similar measures.²³ These sanctions programmes have been administered by the Department of Treasury's Office of Foreign Assets Control, which is authorized to write the regulations imposing sanctions, often on an extra-territorial basis, which has sometimes resulting in severe diplomatic tensions between the US and its trading partners (Alerasool, 1993, 76–91).

The president's vast authority and discretion to impose sanctions under the TWEA was limited by Congress in 1976 when it enacted the National Emergencies Act (NEA).²⁴ The NEA terminated the state of national emergency that President Truman had declared in 1950. The NEA prohibited the president from adopting new sanctions programmes against other targeted states and entities except during times of declared war. The NEA, however, contained a 'grandfather clause' that allowed extant sanctions programmes that had been adopted pursuant to the TWEA to remain in effect.²⁵

*International Emergency Economic Powers Act*²⁶

After the NEA was enacted, Congress was concerned that the executive branch had no effective policy instrument to restrict private international financial transactions as part of an overall economic sanctions policy in times of undeclared war. As a result, it enacted the International Emergency Economic Powers Act (IEEPA), which authorised the president to impose controls on financial transactions and any property in which a designated state or its nationals have an interest. Unlike the TWEA, however, Congress imposed certain conditions on the President's exercise of such powers: (1) the President must declare a peacetime national emergency; (2) make certain findings; and (3) notify the Congress of these findings. The IEEPA recodifies virtually the same range of powers that the president had utilised under section 5(b) of TWEA.

The IEEPA is intended to deal with any new national emergencies and 'any unusual and extraordinary threat, which has its source in whole or

Delegating to the Executive Extraordinary Authority in Time of National Emergency, 93 Cong., 1st Sess. 594 (Comm. Print 1973).

²³ Exec. Order No. 11,387; 3 C.F.R. §702 (1970). See also *Teague v. Regional Commr. of Customs*, 404 F.2d 441 (2d. Cir. 1968), *cert. den.*, 394 U.S. 977.

²⁴ 50 U.S.C. secs 1601 & 1602. Congress's reassertion of political control over economic sanctions policy during this period resulted in part from a decline in presidential influence that stemmed from the Vietnam conflict and the Watergate scandal.

²⁵ This meant that the sanctions programmes that were in effect in 1976 against North Korea, Cuba, Cambodia and Vietnam remained in effect pursuant to the president's powers under section 5(b) of the TWEA. In 2008, the only sanctions programmes that remain in effect under section 5(b) are those against Cuba and North Korea.

²⁶ 50 U.S.C. secs 1701 *et seq.*

substantial part outside the United States, to the national security, foreign policy or economy'.²⁷ If the president determines that such a threat exists, he has discretion to declare a national emergency under the NEA and impose a wide range of economic and financial sanctions pursuant to the IEEPA.²⁸ Although the IEEPA requires Congress to review presidential decisions to impose economic sanctions, it essentially maintains the president's authority to impose sweeping economic controls that prohibit the foreign branches, subsidiaries and affiliates of US companies from conducting or financing trade with targeted state and entities.

Based on the IEEPA, President Clinton issued Executive Order 12,947²⁹ in 1995 that delegated authority to the Treasury to designate certain non-state terrorist organisations, including the Palestinian organisation Hamas, as 'Specially Designated Terrorists', or SDTs, and blocked all their property and interests in property. The order also provided for designations of organisations or persons who are found to be 'owned or controlled by, or to act for or on behalf of' a SDT. Similarly, President Bush relied on IEEPA to issue Executive Order 13,224 on 23 September 2001 that delegated authority to the Treasury to designate specific terrorist organisations as 'Specially Designated Global Terrorists' (SDGTs) and to block all their property or interests in property subject to the jurisdiction of the United States.³⁰ Hamas and other terrorist groups who were designated as SDTs under the 1995 order were also designated as SDGTs under the 2001 order. The 2001 order also allowed for additional SDGTs to be designated if organisations or persons are found to 'act for or on behalf of' or are 'owned or controlled by' designated terrorists.³¹ They could also be designated if they 'assist in, sponsor, or provide... support for', or are 'otherwise associated' with them. Under both orders, the scope of the blocking order is very broad and implicates a number of issues regarding the liability of affiliated companies and third party advisers and associated individuals.

The policy objective behind these economic sanctions statutes was to delegate authority to the president to decide which states, entities or individuals should be targeted on foreign policy or national security grounds and to devise regulations that would restrict their access to US commerce and trade and to block temporarily their use of property connected to the US economy. Some important features of this policy should be noted. First, economic sanctions were target-specific: they imposed controls and

²⁷ *Ibid.*, sec. 1701 (2004).

²⁸ *Ibid.*, The National Emergencies Act, Pub. L. 94-412, 90 Stat. 1255 (1976) *codified at* 50 U.S.C. §1601-1651 (1992). The IEEPA was first invoked by President Carter in 1979 against Iran during the Iranian hostage crisis.

²⁹ Exec. Order No. 12, 947 (60 Fed Reg. 5079 (23 Jan 1995)).

³⁰ Exec Order No 13,224 (66 Fed Reg. 49,079 (23 Sept. 2001)).

³¹ See *Islamic American Relief Agency (IARA-USA) v. Gonzales et al.*, 477 F.3d 728, 732 (DC Cir., 2007).

prohibitions on government and private sector trade, investment and loans with targeted states, entities or individuals. Their scope, design and intensity were determined by the attitude of the US government towards the particular target state or person. Second, under the US constitution, all authority to regulate international commerce, including imposing sanctions, rests with the Congress, and Congress had decided to delegate its power to impose sanctions to the president acting through the executive branch. Congress could rescind such power by amending its legislation or adopting another statute expressly taking away the president's discretion to decide which targets or the type of sanctions to impose. Congress's delegation of such authority to the president would seem to fit the policy objective of promoting the efficient exercise of foreign policy by authorising the president as executive agent of the legislature in designing and implementing sanctions measures to promote Congress's overall foreign policy and national security objectives. Third, the sweeping language in the legislation – authorising the president to take all necessary measures to control and restrict the use of all property, assets or evidence of assets wherever located if the president declared a national emergency and determined that regulating such property or interests in property would be necessary to achieve US foreign or national security objectives – could potentially raise concerns regarding whether the president was acting *ultra vires* or outside constitutional authority. Moreover, the extra-territorial dimension of the president's powers could have the effect of diminishing the need for the president to use diplomatic efforts to co-ordinate bilateral or regional efforts with other countries to impose sanctions against a target state. As discussed in Chapter 8, third country states view the extra-territorial application of US sanctions to be infringements on their sovereignty and territorial integrity.

The Export Administration Act

Immediately following World War II, the drastic wartime export controls which were imposed under the Neutrality Act of 1939 by the US government were continued. The Neutrality Act authorised Congress to renew the president's authority on an annual basis to determine which products could be exported and to what destination. Congress's annual renewal of the president's power to control exports continued until 1949 when Congress enacted the Export Control Act of 1949 (ECA).³² Congress considered the ECA a temporary measure that had three main purposes: (1) to

³² Export Control Act of 1949(ECA). Pub. L. No. 11, 81st Cong., 1st Sess. (1949). The ECA was a codification of previous export control statutes and regulations that had been imposed during World War II. The ECA was replaced by the Export Administration Act of 1969, which loosened some of the strictures that had applied to export controls for communist countries. See Malloy (1988, 191–195).

prevent vital economic supplies from being exported from the US as the world was emerging from war and experiencing great shortages of many goods; (2) to channel exports to countries that the United States most wanted to provide assistance through such programmes as the Marshall Plan; and (3) as Cold War tensions increased after the communist coup in Czechoslovakia and the Berlin blockade in 1948, to prevent the Soviet Union and the Communist Chinese government from obtaining any goods or technology that might enhance their ability to export communist ideology and to increase their military power (Berman and Garson, 1967, 791). The ECA was originally intended to lapse in 1951, but the increase in international tensions resulting from the Korean War caused Congress to renew it.

The ECA codified Congress's wartime policy that prohibited the export of all goods and technology from the US unless the exporter obtained a license from the Department of Commerce. Most countries of destination and most exported products required a general license for export.³³ In the case of products or services which contained or involved some strategic value, such as advanced technology, an exporter was required to obtain a validated license for all countries of destination. With respect to communist countries, validated licenses were required for most products; the application process for validated licenses was very strict and licenses were seldom granted. Although the regulations applied different licensing policies and requirements to different countries, the primary orientation of the ECA was on the control of all strategic exports for commodities, products, services and technologies, notwithstanding the destination of the exports.³⁴ This is in distinct contrast to the Trading with the Enemy Act and the International Emergency Economic Powers Act that authorised the President to impose embargoes and other economic sanctions against specific countries, or persons during a declared national emergency.

The Export Control Act contained a very broad statement of policy and an equally broad mandate to the President 'to effectuate the policies set forth [in the Act]' without having to declare a national emergency.³⁵ The authority granted to the president under the statute was delegated by successive presidents to the Secretary of Commerce under whose direction an elaborate system of regulations and procedures were

³³ This licensing requirement has been maintained since that time with successor statutes. The Export Control Act was never enacted as permanent legislation, but it was extended in 1951, 1953, 1956, 1958, 1960, 1962 and 1965. In 1969, Congress replaced it with the Export Administration Act, which was in turn extended in 1972, 1977, 1979 and 1995.

³⁴ These regulatory guidelines were often hard to comprehend and were never clearly delineated. See Lowenfeld (1983, 8).

³⁵ *Ibid.*

developed over the years to administer the Export Control Programme.³⁶ Under the Act, an export without a license, or under license issued by false or misleading statements, was a crime punishable by fines and imprisonment. Enforcement of the Act was handled by the Bureau of Export Administration, a division of the Department of Commerce.

The Export Control Act expired in December of 1969, and Congress replaced it with the Export Administration Act (EAA), which contained similar restrictions and prohibitions on exports. The EAA retained the basic principle that all exports from the United States are prohibited unless they are licensed by the Department of Commerce, and the export of specified goods and technology to certain countries was prohibited unless a special or validated license was obtained. Moreover, the three broad purposes of the ECA were continued under the EAA, namely, preventing domestic supply shortages, assisting European and Asian economic recovery, and preventing technological and military assistance for the Sino-Soviet bloc. Congress reauthorised the Executive branch to determine which goods or services would be restricted on grounds of national security.

The EAA, however, did contain important changes: First, the US Congress recognised the positive benefits of export trade to economic growth as it became stated policy to promote trade relations between the US and all countries with whom it had diplomatic relations and to use US exports as a basis of sound growth and stability for its economy. Rather than restrict exports, the US government now undertook a policy of active export promotion. Second, the policy of completely denying exports to communist countries was replaced by a narrower policy goal of prohibiting exports to communist countries only if such exports directly assisted the technological and military capabilities of countries supporting the Sino-Soviet bloc (Malloy, 1988, 64–68). US policymakers now were attempting to calibrate a fine balance between promoting US exports in an increasing global economy while maintaining strict standards for US national security interests.

During the 1970s, the US government began to use export controls to promote broader foreign policy objectives, rather than for the narrower objective of preventing the transfer of technology and military parts to the eastern bloc. The use of export controls by the US before 1970 to accomplish foreign policy objectives had been quite rare and was limited in its coverage. During the 1960s, such controls had been used in three types of situations: (1) assisting the United Nations in implementing its own sanctions, particularly in the 1960s and 1970s against Southern Rhodesia; (2) assisting the International Atomic Energy Agency in controlling the export of nuclear materials; and (3) broader sanctions designed to maintain

³⁶ For a thorough account and critique of the Export Control Program as it stood in the 1960s, see Abbott (1981).

political stability in volatile regions of the world, such as the Middle East (Abbot, 1981, 760).

In the 1970s, the use of export controls to accomplish diplomatic objectives became more important as international terrorism and human rights abuses prompted the Congress and the Carter administration to enact in 1977 amendments to the EAA.³⁷ The amendments essentially required the President to use export controls 'to encourage other countries to take immediate measures to prevent the use of their territories or resources to aid, encourage, or give sanctuary to' international terrorists.³⁸ This provision was quickly cited by the Carter administration as it increased export controls against Libya in 1978 by prohibiting the sale or lease of aircraft or aircraft parts to US and non-US businesses doing business in Libya. Moreover, the need to use export controls for foreign policy purposes was heightened by the concern for protecting human rights as recognised by international conventions. Although the EAA provided no explicit recognition for the protection of human rights, its later amendments prohibited the export of crime control equipment to countries which were using the equipment for torture and for repressing political dissidents (Abbott, 1981, 786–788). In 1974, amendments to the EAA required a specific license to export such equipment to communist countries, and in 1978 these regulations were expanded to include all countries outside of the NATO alliance except Japan, Australia, and New Zealand (Ibid.).

These export control regulations were combined with a mandatory trade embargo imposed by Congress in 1978 against the regime of Uganda's Idi Amin.³⁹ The US trade embargo against Uganda was imposed on the grounds that the Amin regime had committed genocidal atrocities in violation of *jus cogens* norms of international law and therefore the US was acting on behalf of the international community in attempting to bring about a collapse of the Amin regime, which occurred in 1979. This was the first US economic embargo imposed against a country that was not based on the president's emergency powers in the TWEA or IEEPA. Moreover, as part of its escalation of economic and diplomatic pressure against the apartheid policies of South Africa, the Carter administration relied on powers granted by the 1969 EAA to impose in 1978 an embargo

³⁷ Export Administration Act Amendments of 1977, Pub. L. No. 95–52, sec. 115, 91 Stat. 235 (codified at 50 U.S.C. §2402 (8)). The 1977 amendments were part of a broader legislative policy to combat terrorism; other efforts included similar provisions in laws regarding foreign assistance, and prohibitions against US directors of public international financial institutions, such as the World Bank and IMF, voting against countries supporting terrorists.

³⁸ Export Administration Act Amendments of 1977, Pub. L. No. 95–52, §115, 91 Stat. 235 (codified at 50 U.S.C. §2402 (8) (1979)).

³⁹ Bretton Woods Agreement Amendments Act, Pub. L. No. 95–435, §§5(c)–(d), 92 Stat. 1051 (1978).

of all US-origin goods and unpublished technical information to any 'military and police entities' in South Africa. The US government's stated purpose for imposing these sanctions was to further both the United Nations arms embargo of South Africa and to promote US foreign policy on human rights (Ibid.).

President Carter also imposed in 1978 additional restrictions on exports to the Soviet Union on most types of technology and equipment used for the exploration and production of oil and natural gas. Although restrictions had already been imposed on certain types of equipment and technology, the 1978 controls were imposed to 'be consistent with the foreign policy objectives of the United States'.⁴⁰ When Congress began deliberations to renew the 1969 EAA, it had become apparent that the purpose of US export control policy had undergone significant change from that of being primarily concerned with the export of goods and technology for strategic and economic supply reasons to that of shaping export policy according to broader foreign policy and international objectives. Moreover, there was also a concern that the administrative process for considering export licenses had become too cumbersome and that this proved to be an obstacle to the emerging US policy of promoting increased exports (Bingham and Johnson, 1979, 894). These factors proved important in influencing Congress to make significant changes to the EAA of 1979.

The 1979 Export Administration Act

Congress adopted important changes to the EAA in 1979; these changes provided the essential legal framework which remains in place today.⁴¹ The most fundamental structural change of the statute was to separate the provisions on national security controls and foreign policy controls into two separate sections and require that they be treated differently. The basic criterion for national security controls remains whether the exports can significantly contribute to the military capability of any country or any combination of countries which would threaten US national security interests.⁴² Regarding foreign policy controls, the 1979 Act codified and sought to circumscribe the use of these controls which had increased significantly during the 1970s. The basic purpose of the controls was to 'restrict the export of goods and technology where necessary to further significantly the foreign policy of the United States or to fulfil its declared international

⁴⁰ Fed. Reg. 33,699 (1978).

⁴¹ Pub. L. No. 96-72, 93 Stat. 503 (1979)(codified at 50 U.S.C. app. §§2401-2420 (1982).

⁴² 50 U.S.C. §2402 (2)(A). The 1979 Act shifted some of the authority for approving license applications on the grounds of national security to the Department of Defense. secs. 2403 (a)(1) and (c)(2), 2409(g).

obligations'.⁴³ When considering whether to impose export controls for foreign policy reasons, however, the president is required to follow certain guidelines and to take specific steps before imposing controls.⁴⁴

Moreover, specific amendments were inserted into the Act that prohibited the approval of specific licenses to exporters seeking to export any products or services to countries which have been designated as supporting international terrorism. The Act further requires that all export controls expire after being in effect for one year unless the president reports to Congress and makes certain findings to show that the controls still satisfied the initial criteria for their imposition.⁴⁵

The 1979 Act's first major test was in December 1979 when the Soviet Union invaded Afghanistan. President Carter responded by ordering a number of controls on exports to the Soviet Union and based his orders on national security and foreign policy grounds. One order imposed a temporary ban on the export of high technology to the Soviets. In January 1980, Carter directed the Secretary of Commerce to begin a review of US policy on all technology exports to the Soviet Union, to suspend the issuance of new validated licenses until the review was completed, and to suspend the previously issued validated licenses where the export had not yet occurred.⁴⁶ More controversially, Carter terminated shipments of agricultural products, including wheat and corn, to the Soviet Union; this resulted in the cancellation of 17 million tons of grain exports, as well as sales of other agricultural products (Moyer and Mabry, 1983).

Although this embargo had considerable symbolic significance, its economic impact on the Soviets was limited as they shifted their purchases of agricultural goods to other sources (Ibid., 73). Although President Carter justified the sanctions on national security and foreign policy grounds, most observers are in agreement that national security objectives were not a true factor in deciding whether to embargo agricultural products to the Soviet Union, and that the real reason was that the imposition of controls for national security objectives exempted the president from having to comply with the procedural requirements of the EAA that apply when

⁴³ 50 U.S.C. s. 2402 (2)(B).

⁴⁴ 50 U.S.C. §2405 (b). For instance, the statute requires the President to 'determine that reasonable efforts have been made to achieve the purposes of the controls through negotiations or other alternative means'. Ibid. at §2405 (d). The president must also consult Congress 'in every possible instance'. Ibid., §2405 (e). Moreover, the Secretary of Commerce is required to 'consult with such affected United States industries as the Secretary considers appropriate'. Ibid., §2405 (c).

⁴⁵ 50 U.S.C. app. §2405 (a)(2) (1982).

⁴⁶ .45 Fed. Register 3027 (1980); Subcomm. on Europe and the Middle East of the House Comm on Foreign Affairs, 97th Cong., 1st sess., *An Assessment of the Afghanistan Sanctions: Implications for Trade and Diplomacy in the 1980s*, 65 (1981) (report prepared by Congressional Research Service).

controls are imposed for foreign policy reasons. In March of 1980, Carter relied on the 1979 Act as a basis to prohibit all exports to the Soviet Union of any goods or technology in connection with the Olympic games. Carter then broadened the sanctions by prohibiting any payments or transactions that could provide financial support for the Olympic games. The legal basis for this order was found in a provision of the EAA which authorised controls over 'financing' in order to implement broader export control policies; it did not provide independent authority to the president to impose private international financial controls.⁴⁷ The president's expansive use of export controls to include financial transactions demonstrated the broad application of US export controls.

In June 1982, President Reagan imposed an unprecedented expansion of trade controls against the Soviet Union; these controls were imposed on exports on oil and gas equipment and technology and were designed, *inter alia*, to obstruct Soviet construction of the Yamal natural gas pipeline to Europe.⁴⁸ These economic sanctions were a substantial extension of a series of controls that had been imposed against the Soviets Union during late 1981 for repression in Poland. The sanctions were known as the pipeline controls and raised issues of both contract sanctity and the extra-territorial nature of US economic sanctions. The sanctions met with great resistance not only from US allies but also from within Congress and from the US business community. In response to such opposition, and to affirmative acts by European countries to neutralise the effect of the sanctions on businesses operating in Europe, the Administration rescinded the controls in November 1982. The episode caused substantial political tension between the US and its European allies which had only begun to dissipate in the early 1990s when Congress enacted the extra-territorial measures of the Cuban Democracy Act and Helms-Burton Act which imposed liability against third country nationals with a US presence who trade with Cuba. In addition to the exports controls against the USSR, both the Carter and Reagan administrations began to target export controls in the late 1970s and 1980s against states allegedly involved in supporting terrorism, such as Iran and Libya.

Export Administration Act Amendments

The Export Administration Amendments Act of 1985 was the product long and tortuous negotiations between the Congress and Reagan Administration. After political negotiations to renew the EAA had reached impasse and with the Act set to expire, the president declared a national emergency and invoked the International Emergency Economic Powers Act (IEEPA) to continue the export control programme until Congress reinstated the EAA

⁴⁷ 50 U.S.C. §2406(g)(3) (1982).

⁴⁸ Fed. Reg. 27,250 (1982).

temporarily for a four month period while further negotiations continued over its terms and conditions. When the four month period expired, President again declared a national emergency to keep the export control programme in effect while negotiations continued which resulted in agreement in 1985 when a new EAA was enacted. Although the 1985 Act essentially extended the 1979 Act and its basic structure, it contained several significant changes, most important of which for our purposes were the further restrictions on the President's authority to impose export controls without consultation with Congress, new provision protecting the sanctity of contracts which are in effect at the time sanctions are imposed, and more procedural requirements for the president to fulfil when deciding to impose economic sanctions for foreign policy purposes.

The most bitterly contested provision of the 1985 Amendments were the new restrictions on the president's power to impose export controls that abrogate existing contracts. The issue of contract sanctity became important during both President Carter's agricultural embargo of the Soviet Union and President Reagan's pipeline embargo which prohibited the non-US subsidiaries of US companies and any third country national who possessed US technology or parts that were being sold or used by the Soviet Union in its pipeline project. The Carter agricultural embargo had nullified pre-existing contractual obligations for the sale of agricultural exports to the Soviet Union. President Reagan's pipeline embargo went even further by extending controls on exports to non-US subsidiaries of US companies or to persons who were not controlled by any US entity but who had purchased US parts and technology which were subject to stringent end-use restrictions. Moreover, the pipeline controls were applied to prohibit certain exports from a foreign country to the Soviet Union that were subject to an existing contract, if the exported goods had been manufactured on the basis of a licensing agreement with any company subject to US jurisdiction.⁴⁹ The use of sanctions in this manner contributed to the reluctance of foreign investors to purchase or license the products or services of US suppliers.

The 1985 Amendments prohibited the president from imposing foreign policy controls on the export or re-export of goods and technology under existing contracts or validated licenses, unless the President determines and certifies to Congress that (1) 'a breach of the peace poses a serious and direct threat to the strategic interest of the United States', (2) 'the prohibition or curtailment...will be instrumental in remedying the situation posing the direct threat', and (3) 'the export controls will continue only so long as the direct threat persists'.⁵⁰ This provision requires a cause and effect relationship

⁴⁹ Fed. Reg. 27,250 at 27,251 (1982).

⁵⁰ U.S.C. §2405 (m). The section protects exports or re-exports under an existing 'contract or agreement' or 'under a validated license or other authorisation' issued under the EAA. *Ibid.*

between the proposed executive control that suspends the contract and that control's immediate effect on a situation that directly threatens US strategic interests. Since the 1985 Act, US presidents have not sought to use this authority under the EAA to nullify contractual obligations to accomplish foreign policy objectives during a non-emergency period, but they have intervened pursuant to their emergency powers under both the Trading With The Enemy Act and the International Economic Powers Act to nullify existing banking and other financial contracts in order to interdict financial relationships between targeted states and US business entities.

The Congress enacted significant revisions to the EAA in 1995 as part of a restructuring of US export control policy. The 1995 Amendments increased the scope and amount of penalties and fines for violations of the export control provisions of the Act, and the Bureau of Export Administration (BXA) continued to exercise its regulatory authority over anyone violating the EAA or its regulations with the power to suspend export privileges.⁵¹ Following the September 11 attacks, the BXA was transferred and consolidated into the Department of Homeland Security's Bureau of Industry and Security (BIS) which now has oversight of the Export Administration Act. The BIS has the main responsibility for the EAR and has adopted additional regulatory controls for export licences for most exports of dual-use US-origin products, component parts, services and technology. The EARs continue to impose extra-territorial export controls on third country persons who seek to re-export US-origin goods, services or technology to other countries which are designated under the EAA as requiring a specific licence or which may be prohibited altogether from receiving US re-exports of any kind.

US export controls continue to apply to transactions outside the United States by subjecting goods and technology that have been exported from the US to a third country to re-export authorisation before these items can be re-exported to a targeted state or person. Many re-exports, however, will qualify for an exception from licensing requirements under the 1995 amendments, especially with regard to US component parts which, if they do not comprise 10 per cent of the value of a product assembled in a third country, require no license to be re-exported to a targeted state or its national. Regarding the production abroad of certain goods and technology which are based on the use of US technology, the 1995 amendment imposed the requirement that the authorisation to export technology from the United States will be subject to assurances that items produced abroad that are the direct product of that technology will not be exported to certain destinations without prior authorisation. As in the case of direct US exports, the extent

⁵¹ The 1995 amendments clarified the BXA's power to subject illegal exports to seizure and forfeiture. The amendments use strict liability as the legal standard for imposing civil penalties and other administrative sanctions.

of control over a particular foreign transaction will depend on the goods or technology, the destination, the end use and the end user.

The strategic focus of the EAA has traditionally been on export and re-export controls of particular products, services and technology, while the general focus of the TWEA and IEEPA has been on restricting all commercial and financial activities of US persons and US-controlled persons with targeted states and entities. Nevertheless, their functions often overlap as export licences must often be approved by both the BIS and the OFAC. Together, BIS and OFAC regulations provide the most comprehensive set of economic sanctions controls of any country. The EAA, IEEPA and TWEA all provide the president with broad authority to monitor the application and effectiveness of sanctions programmes whilst delegating discretion to the president to adjust their intensity and scope according to the needs of US foreign policy. Executive discretion is also necessary for coordinating the application of sanctions on a cross-border basis with other countries and within regional and multilateral institutions. In contrast, prescriptive legislative intervention in this area can constrain the executive's discretion and in some cases undermine the effectiveness and flexibility of a state's sanctions policy because of the potential for legislative micro-managing of executive conduct and of sending conflicting signals from different branches of government. Nevertheless, legislative oversight should be an important component of any state's sanctions regime and should complement, rather than obstruct or contradict, the executive's management of sanctions practice.

Iran/Libya Sanctions Act of 1996

The Iran/Libya Sanctions Act⁵² (ILSA) was enacted in 1996 as part of a broader congressional intervention into the president's conduct of sanctions policy that intended to increase US sanctions against targeted states and international terrorism. ILSA supplemented existing export controls and foreign asset controls that were already in place against Iran and Libya by imposing a secondary boycott upon foreign firms which make major investments in the Iranian or Libyan petroleum industry. The ILSA was a direct reaction to the increasing emergence of the United States as a prime target for acts of international terrorism and also reflected Congress's intent to codify certain US sanctions practices against Iran and Libya and to restrict the president's discretion to manage sanctions policy against Iran and Libya and to ensure that the US effectively implemented Security Council resolutions 748 and 883 prohibiting the sale of aircraft parts and prohibiting financial transactions with Libya. It also reflected Congress's intent to impose sanctions against non-US third country persons who invest

⁵² Iran and Libya Sanctions Act of 1996, Pub. L. 104-172, 110 Stat. 1541 (5 Aug. 1996), 35 I.L.M. 1273 (1997).

substantial amounts into the oil and gas sectors of Iran and Libya and to make it more difficult for the president to modify the extra-territorial application of US sanctions against Iran and Libya without congressional approval.⁵³

The ILSA attracted fierce controversy from US trading partners and foreign businesses. Its extra-territorial provisions were more expansive than other US sanctions laws in so far as it imposed jurisdiction on all foreign nationals, regardless of where they conducted their transactions, who undertook substantial trade or investment in the Iranian or Libyan energy sectors or in weapons manufacturing that violated treaties governing the use of weapons of mass destruction or the nuclear non-proliferation treaty. Unlike other US sanctions laws where the Treasury takes the lead on investigations and enforcement, the US State Department has sole authority to enforce the Act. The ILSA had no retroactive effect and required no disinvestment by non-US companies which had already invested in Iranian or Libyan development projects. ILSA's effect on US persons or US-controlled foreign persons was cumulative and in addition to obligations and restrictions that were already binding in 1996 which had prohibited most investment and trade with Iran or Libya.

In 2006, the law was amended to exclude foreign investment or trade with Libya as a sanctionable act. The 2006 amendments to ILSA do not change its key provisions as they apply to foreign trade and investment with Iran. Specifically, it requires (with certain exceptions) that the President impose economic sanctions against any 'person' who 'has, with actual knowledge', on or after 5 August, 1996, committed any of the following acts: investing forty million US\$ or more in any twelve month period (reduced to twenty million US\$ per year after 5 August, 1997) 'that directly and significantly contributed to the enhancement of Iran's ability to develop petroleum resources of Iran'.⁵⁴ This prohibition against aggregate investments that equal or exceed twenty million per year applies to 'any combination of investments' of at least five million US\$ each of which, in the aggregate, equals or exceeds twenty million US\$ per year.⁵⁵

Before the 2006 amendments, tight restrictions had applied to foreign commerce and investment with Libya that prohibited any investments or transactions involving Libya in which 'any goods, services, technology' are 'exported, transferred, or otherwise provided to Libya' which were prohibited

⁵³ Congress also enacted the Cuban Liberty and Democratic Solidarity Act of 1996 that codified most parts of the Cuban trade embargo and enhanced overall US sanctions against Cuba and third country persons who invest in Cuba. See discussion in Chapter 7.

⁵⁴ ILSA s. 5(a).

⁵⁵ ILSA s. 4(d)(1).

under United Nations Security Council Resolutions 748 and 883⁵⁶ and which had significantly contributed to Libya's ability to acquire chemical, biological or nuclear weapons or to enhance its military capabilities, or contributed to its ability to develop its petroleum resources, or contributed to its ability to maintain its aviation capabilities.⁵⁷

The purchase of petroleum products or other goods from Iran and Libya by non-US firms, however, was not subject to sanction. The law did prohibit US financial institutions from making loans or granting credits over ten million US\$ to non-US investors in Iran or Libya.⁵⁸ The law also prohibited non-US investors in Iran or Libya from importing goods into the United States and denied them an export licence for goods of US origin. Although several investigations have been conducted, no sanctions have been imposed under this law. Moreover, various other sanctions are imposed, including the denial by the US Export-Import Bank of credit and credit guarantees to a sanctioned person;⁵⁹ the prohibition of any sanctioned financial institution from serving as a dealer in US government debt instruments or as a repository of US government funds;⁶⁰ the prohibition of the US government from entering into procurement contracts with any sanctioned person.⁶¹ These prohibitions are not exclusive and the president has discretion to impose other sanctions.⁶²

In certain circumstances, the president can delay or waive the imposition of sanctions against foreign persons with respect to investments in Iran.⁶³ In the case of 'services provided under contracts entered into before the effective date' of the law, the imposition of sanctions is discretionary, rather than mandatory.⁶⁴ This waiver authority is intended to protect the sanctity of certain contracts that were executed covering transactions from which obligations arose before the effective date of the sanctions. Moreover, the president may delay the imposition of sanctions for up to ninety days in order to consult with the government of the country of a sanctioned foreign person.⁶⁵ If the government with 'primary jurisdiction' over that person takes action to terminate the activity that triggered the sanctions determination, the president may delay the actual imposition of sanctions for an additional ninety days.⁶⁶ Further, regarding third country investment in

⁵⁶ *Ibid.*, s. 5(b).

⁵⁷ *Ibid.*, s. 5(b).

⁵⁸ *Ibid.* 6(3), 110 Stat. at 1545.

⁵⁹ *Ibid.* 6(1), 110 Stat. at 1545.

⁶⁰ *Ibid.* 6(4), 110 Stat. at 1545.

⁶¹ ILSA 6(5), 110 Stat. at 1545.

⁶² *Ibid.*, 6(6), 110 Stat. at 1546. The president may impose such additional sanctions to restrict imports. *Ibid.*

⁶³ *Ibid.* 9(a), 110 stat. at 1546.

⁶⁴ ILSA §5(f)(3).

⁶⁵ *Ibid.*, s.9(a)(2).

⁶⁶ *Ibid.*, s.9(a)(3).

Iran, the President may waive sanctions as to an entire country if its government 'has agreed to undertake substantial measures, including economic sanctions, that will inhibit Iran's efforts' to acquire weapons of mass destruction and to support terrorist activities.⁶⁷ Such measures need not be modelled exactly on US sanctions, but they must inhibit Iranian efforts 'to threaten international peace and security'.⁶⁸

In addition, upon thirty days' notice to Congress, the president may waive the initial or continued imposition of a sanction upon a specified person if 'it is important to the national interest of the United States' to do so.⁶⁹ This is intended to be broad enough to include instances when the imposition of sanctions 'would be violative [of] international trade obligations',⁷⁰ and 'where sanctions would lead to unacceptable costs to US economic interests',⁷¹ and situations where serious diplomatic disputes arise because of conflicting jurisdiction between the US and other states.⁷² Although ILSA provides the president with some discretion in exercising sanctions authority, it limits executive discretion in choosing which sanctions measures to apply and in deciding whether to invoke a waiver.

Once sanctions have been imposed, they must remain in effect for at least two years.⁷³ After the sanctions have been in effect for one year, the president may suspend them before the end of the two year period by making a determination and certifying it to Congress that a sanctioned person has terminated his sanctionable activities and that there are 'reliable assurances that such person will not knowingly engage in such activities in the future'.⁷⁴ The statute originally stated that ILSA would expire on 5 August 2001, but it was renewed in 2001 and then again for five more years in 2006 after it was amended to exclude as sanctionable acts investments in Libya. Presently, sanctions cannot be imposed for acts committed after the present expiry date of August 2011. But for acts committed before that date, it is presumed that sanctions could be imposed.⁷⁵ In the situation where ILSA may expire within a two-year period, the statute prescribes certain requirements for terminating the sanctions as they apply to investments in Iran. The requirements are that the president must certify to Congress that Iran has ceased its efforts to acquire nuclear, chemical and biological, and ballistic missiles and related launch technology. Moreover, Iran must have ended its support

⁶⁷ *Ibid.*, s.4(c).

⁶⁸ H.R. Rep. No. 104-523, pt. 2, at 12.

⁶⁹ *Ibid.*, s.9(c)(1).

⁷⁰ Cong. Rec. H6478 (daily ed. 18 June 1996; remarks of Rep. Archer, Chairman of the House Ways and Means Committee).

⁷¹ H.R. Rep. No. 104-523, pt. 2, at 18.

⁷² *Ibid.*

⁷³ ILSA s.9(b)(1).

⁷⁴ *Ibid.*, s.9(b)(2).

⁷⁵ 1 U.S.C. §109 (1994).

for international terrorist groups and thereby be removed from the list of governments in the Terrorism List Governments Sanctions Regulations⁷⁶ as a state that directs or actively supports international terrorism.⁷⁷

The companies and persons eligible to be sanctioned are as follows. The non-US person or firm who makes prohibited investments in Iran is subject to sanction along with its successors, parent or holding companies, subsidiaries, or controlled affiliates or entities, if they have 'actual knowledge' or engage in the prohibited activities with actual knowledge.⁷⁸ Accordingly, sanctions may be imposed against a parent corporation or controlling entity that supervises, guarantees or invests in the prohibited activities of a subsidiary or other controlled person.⁷⁹ This provision is significant because it allows sanctions to be imposed against other non-US persons, such as corporations, other business entities, and natural persons who by virtue of their involvement with affiliated companies have either knowingly engaged in prohibited investments or have 'actual knowledge' of their controlled-persons undertaking such investments.⁸⁰

Regarding judicial review, the ILSA provides that '[a] determination to impose sanctions under this Act shall not be reviewable in any court'.⁸¹ It is unclear, however, whether this provision prohibits judicial review of a sanction

⁷⁶ See 31 C.F.R. §596 (2006).

⁷⁷ In the case of Libya, President Bush issued an executive order in April 2006 certifying that Libya 'has fulfilled the requirements of U.N. Security Council Resolutions 731, 748 and 883'.

⁷⁸ *Ibid.*, s.5(c).

⁷⁹ *Ibid.*, See also 142 Cong. Rec. H6476 (daily ed. 18 June 1996; colloquy between Reps. Gilman and Gejdenson).

⁸⁰ Once a person is determined to have violated the prohibitions and to be ineligible for one of the exceptions, such as the one for contract sanctity (sec. 5(f)), the president is required to impose at least two of the seven sanctions listed in section 6 based upon any person violating the investment or trade prohibitions set forth in section 5, unless the president determines that to do so would threaten 'the national interest of the United States (sec. 5). The president may choose from the following measures:

- (1) denial of US Export-Import Bank assistance in connection with exports to the sanctioned person;
- (2) denial of exports from the United States to the sanctioned person of items requiring a 'specific' or validated export license;
- (3) denial of loans or credits from US or US-controlled financial institutions in excess of US\$ 10 million per year (exception for humanitarian activities);
- (4) denial of permission to any sanctioned person, which is a financial institution, to serve as a primary dealer in US government debt instruments (i.e., bonds and notes);
- (5) denial of the right to sell to the US government; and
- (6) denial of the right to export goods or services, or to act on behalf of US persons seeking to import, into the United States.

⁸¹ ILSA s.11.

that was imposed in violation of the US Constitution, though the broad powers of Congress to enact laws to govern foreign relations and its delegation of such powers to the president to carry out the foreign affairs power would militate against a finding that such review would be available, even where a constitutional violation is alleged. The State Department is authorised to provide advisory opinions to persons whose activities may violate the Act and result in sanctions being imposed.⁸² Significantly, persons or entities subject to such regulation may rely in good faith on such advisory opinions, and such opinions may be used later as a defence against an enforcement action as a safe harbour against sanctions.⁸³

Cuban Embargo

Another statute where Congress intervened to limit executive discretion in the management of US sanctions policy was the Cuban Liberty and Democratic Solidarity Act of 1996 (the Helms-Burton Act). One of Congress's objectives in adopting the Helms-Burton Act was to codify the then-thirty four year-old US economic embargo against Cuba.⁸⁴ The Helms-Burton Act requires that the president must maintain the restrictions of the trade embargo and may only provide assistance to a transition government in Cuba when that government has fulfilled eight specified requirements.⁸⁵ In order for the president to provide aid to a democratic government in Cuba, Congress mandated that a future Cuban government would have to meet six additional requirements.⁸⁶ Any assistance to be given to Cuba would be 'subject to an authorization of appropriations and subject to the availability of appropriations'. Thus, no particular level of aid is guaranteed to a transition government in Cuba, and whatever assistance is actually given will depend on the political and economic circumstances in both countries at the time.⁸⁷

As mentioned above, the vast scope and comprehensiveness of the US economic sanctions regime is unprecedented in modern history. As US economic and military influence grew in the twentieth century so did the intensity and scope of its economic sanctions programmes. This suggests that the growing hegemonic influence of the US in world affairs could possibly be one explanation for the intensification and aggressive application of its sanctions programmes. Moreover, the relative increase in US economic

⁸² *Ibid.*, s.7.

⁸³ *Ibid.*

⁸⁴ Indeed, the US embargo of Cuba has been one of the most draconian examples of economic sanctions that has imposed huge economic and social costs on the Cuban economy and society. The substantial economic and social damage done to Cuba by the US embargo will likely remain in effect until the Castro regime is removed from power.

⁸⁵ U.S.C. §203(c).

⁸⁶ *Ibid.*

⁸⁷ *Ibid.*

and military influence following the collapse of the Soviet Union 1991 has been accompanied by a vast expansion of extra-territorial US economic sanctions policies directed not only against US-targeted states, but also non-state actors that include designated foreign drug traffickers and alleged international terrorists, terrorist organisations and their supporters. The stated purpose of extra-territorial US economic sanctions is to isolate targeted states and designated entities by using economic coercion against third country states so that they will participate in a multilateral regime of sanctions enforcement against pariah states and other transnational entities.⁸⁸

The more aggressive, unilateral policy of the US in adopting extra territorial sanctions reflects its hegemonic position in international economic relations and its ability to shape and influence international commerce and investment. Indeed, growing liberalisation and deregulation of financial markets and international trade have led the economies of many countries to become more dependent on US-controlled investment and capital flows, and thereby increasingly constrained by the extra-territorial scope of US regulation. This has enhanced the effectiveness of extra-territorial US sanctions in regulating and influencing the behaviour of third country persons who do business with US-targeted states and entities.

Nevertheless, the increasingly prescriptive nature of US economic sanctions legislation constrains executive discretion in managing and controlling the conduct of sanctions policy and has resulted in conflicting signals from the US government to sanctions targets as well as to third countries whose cooperation is necessary for an effective sanctions policy. Moreover, specific legislative requirements imposing sanctions measures that provide the executive agencies of government with little, if any, discretion to modify or waive their application if the sanctions target changes its behaviour or if circumstances in international relations change, can undermine the effectiveness and legitimacy of a state's sanctions policy.

II United Kingdom

British economic sanctions policy relies on enabling legislation that delegates broad authority to ministers and to the Cabinet to adopt secondary legislation to implement the government's sanctions regime.⁸⁹ During World War I and World War II, UK economic sanctions were imposed pursuant to UK

⁸⁸ Cuban Liberty and Democratic Solidarity Act (LIBERTAD) of 1996, Pub. L. 104–114, 110 Stat. 785 (12 Mar. 1996); *and* Iran/Libya Sanctions Act, Pub. L. 104–172, 110 Stat. 1541, Title I, at §§9–10 (codified at 50 U.S.C. §1701).

⁸⁹ The UK follows a multi-agency approach in administering its economic sanctions programmes. The Department of Business, Enterprise and Regulatory Reform (formerly the DTI) provides advice to industry and administers export/import licensing procedures; the Ministry of Defence has oversight of arms exports and related goods; the Foreign and Commonwealth Office provides policy oversight of

emergency legislation that delegated authority to government ministers to adopt secondary legislation that implemented sanctions against both enemy state and non-state targets.

In practice, the UK government uses two types of secondary legislation to achieve the enabling Act's objectives: (1) statutory instruments and (2) Orders in Council. Statutory instruments are used when the enabling Act confers legislative powers on specific ministers to formulate secondary legislation (i.e., regulations) to achieve the Act's objectives which must be laid before and approved by Parliament. In contrast, when the Act confers legislative powers on the Cabinet as a whole, as opposed to specific ministers, to adopt regulations covered by the enabling power, it will usually provide that this power shall be exercised by 'the Queen in Council'. For example, the United Nations Participation Act 1946 prescribes that when the Security Council adopts resolutions pursuant to Chapter VII of the UN Charter, Her Majesty in Council shall by Order make regulations to secure the UK's compliance with the resolution.⁹⁰ Statutory instruments are the most common form of delegated legislation, whilst Orders in Council are used less often and mainly for policy areas of greater significance, such as making emergency regulations based on the Emergency Powers Act 1920, the United Nations Participation Act 1946 or other national security statutes or legislation dealing with constitutional matters.

The main enabling statutes that authorise the Crown, acting through its ministers, to adopt statutory instruments or Orders in Council that impose economic and financial restrictions as part of UK economic sanctions policy are the following. First, the Import, Export and Customs Powers (Defence) Act of 1939 provides the Secretary of State with broad authority to prohibit the export or import of any good for any reason.⁹¹ Section I(1) provides in relevant part: 'The Board of Trade may by order make such provisions as the Board think is expedient for prohibiting or regulating...the importation into, or exportation from, the United Kingdom...of all goods or goods of any specified description.'⁹² Although the Act was intended to be a temporary measure during World War II, it now provides the legal authority for British export and import licensing requirements.⁹³ The British government

sanctions measures; whilst the Intelligence services provides information and analysis and HM Revenue and Customs provides law enforcement and border control.

⁹⁰ By convention, the Monarch's role is merely formal in issuing the Order, as the Cabinet or the relevant ministers usually devise regulations followed by the Lord President of the Council who summons a few ministers to attend a meeting of the Privy Council presided over by the Monarch whose consent is customarily granted.

⁹¹ The Import, Export and Customs Powers (Defence) Act 1939, 2 & 3 Geo. VI, c. 69.

⁹² *Ibid.*

⁹³ See Import of Goods (Control) Order, S.I. No. 23 (1954)(prohibiting the importation of all goods into the UK except those licensed); See also, Export of Goods

has relied upon the statute as an important component in its policy arsenal for imposing wide-reaching sanctions in the cases of Southern Rhodesia in 1965, Iran in 1980, and Iraq and other countries which have been targeted by UN Security Council sanctions.

Second, the Exchange Control Act 1947 provides broad power for the Secretary of Treasury to issue statutory instruments to restrict or prohibit transactions in foreign exchange.⁹⁴ The British government relied on this Act to issue statutory instruments imposing exchange controls against Southern Rhodesia, Iraq, the Federal Republic of Yugoslavia, and presently maintains foreign exchange restrictions against Burma and designated terrorists and their supporters.⁹⁵ The Emergency Laws Act also imposes payment controls by authorising the Secretary of Treasury to restrict and freeze financial transactions deemed to be a 'detriment of the economic position of the United Kingdom'.⁹⁶ The Emergency Laws Act 1964 provided authority for the Cabinet to issue statutory instruments that prohibited the transfer of gold and securities to various countries, namely, Southern Rhodesia in 1965 and later for asset freeze orders against all Argentine assets in British banks during the Falklands war in 1982.⁹⁷ Moreover, the 1939 Trading with the Enemy Act still provides authority for the Secretary of State to label any country an 'enemy', thereby rendering trade with that country illegal.⁹⁸

The United Nations Act 1946 authorises the Cabinet to exercise the necessary powers to implement mandatory Security Council Resolutions.⁹⁹ Section 1(I) of the Act enables the Crown to adopt Orders in Council to give effect to Security Council sanctions measures under Chapter VII of the Charter,

(Control) Order, S.I. No. 849 (1985) (prohibiting the export from the UK of certain goods unless they are licensed). During the Cold War, this order controlled the export of strategic goods and technology to Communist countries. *Ibid.*, arts. iv, vii.

⁹⁴ Exchange Control Act 1947, 10 & 11 Geo VI, c. 14.

⁹⁵ The government lifted the Southern Rhodesian controls by issuing a general exemption in December of 1979. The Exchange Control (General Exemption) Order, S.I. No. 1660 (1979). Moreover, See UK Emergency Statutory Orders adopted pursuant to the Exchange Control Act. See Emergency Powers, the Control of Gold, Securities, Payments and Credits (Kuwait), S.I. No. 1591 (2 Aug. 1990); See *ibid.* (Iraq) S.I. No. 1616 (4 Aug. 1990). See also S.I. No. 1651 (8 Aug. 1990).

⁹⁶ See The Control of Gold and Treasury Bills (Southern Rhodesia) (Revocation) Directions, S.I. No. 1661 (1979). See also Emergency Laws (Re-Enactment and Repeals) Act 1964, c. 60 [hereinafter Emergency Laws].

⁹⁷ For Southern Rhodesia, see Control of Gold and Treasury Bills (Southern Rhodesia) Directions, S.I. No. 1939 (1965), *revoked* by S.I. No. 1661 (1979). For Argentina, see Control of Gold, Securities, Payments and Credits (Argentine Republic), S.I. No. 512 (1982), *revoked* by S.I. No. 1926 (1982). For discussion of British economic sanctions during Falklands War, see Amine (1983, 404).

⁹⁸ Trading with the Enemy Act 1939, 2 & 3 Geo. VI, c. 89. The law could be used to terminate all commercial transactions with a particular country.

⁹⁹ United Nations Act, c. 45, sec. I, contained in Control of Gold and Treasury Bills (Southern Rhodesia) Directions, S.I. No. 1939 (1965).

including the 'apprehension, trial and punishment of persons offending against the Order'¹⁰⁰ The Act also creates civil liability for those in breach of the Order. The Cabinet has relied on the Act to issue statutory orders implementing the asset freeze orders, travel bans and other sanctions required by the Security Council in the 1990s and 2000s.¹⁰¹ Similarly, the Cabinet has the power to implement European Community legislation that adopts unilateral EU sanctions independent of Security Council sanctions requirements.¹⁰²

Regarding export controls for dual-use goods and services, the Export Control Act 2002 provides the most comprehensive coverage of UK export controls. It consolidates and incorporates previous UK export control legislation, including the Import, Export and Customs Powers (Defence) Act of 1939.¹⁰³ The Export Control Act was adopted in response to the recommendations of the Scott Report of 1996. Parliament implemented the Act through secondary legislation which became effective in May 2004. The Act imports a licensing regime for the export of military and dual-use goods and instruments, and requires licences for software and technology products and services. The Act focuses mainly on export controls and establishes a government objective to promote global security by restricting exports to UN-targeted states and international terrorists.

Although these laws provide broad statutory authority for the Cabinet to impose far-reaching controls over exports, imports and financial transactions, the British Cabinet will often seek specific approval from parliament when responding to a particular crisis. In a particular crisis, it is necessary for parliament to enact country-specific legislation imposing direct prohibitions on certain transactions and commercial dealings with a targeted state.¹⁰⁴ This was the case in the two World Wars when Parliament adopted specific legislation targeting Axis countries and their nationals and was later the case in the 1960s with UK legislation authorising the adoption of secondary legislation targeting Southern Rhodesia.

The delegation of lawmaking authority to government ministers has been recognised as essential to an efficient legislative and administrative process and it has enhanced the effectiveness of UK economic sanctions policy, but it raises concerns regarding the type of restraints that should be placed on ministerial discretion to prevent the abuse of administrative and regulatory

¹⁰⁰ United Nations Act 1946, s.1(I).

¹⁰¹ See Iraq & Kuwait, S.I. No. 1651 (1990) (SC Res. 687); Serbia and Montenegro, S.I. No. 1302 (1992)(SC Res. 757) & S.I. 1188 (1993)(SC Res 820); Libya, S.I. Nos. 973 & 975 (1992)(SC Res. 748) and S.I. 1993 No. 2807(SC Res. 883; UN Arms Embargoes (Liberia, Somalia & Former Yugoslavia), S.I. No. 1787 (1993); Former Yugoslavia, S.I. No. 2673 (1994) Terrorism (United Nations Measures) Order 2006 (2006 No. 2657); Al-Qaida and Taliban (United Nations Measures) Order 2006 (2006 No. 2952).

¹⁰² European Communities Act 1972, c.68, ss.2(2), (4).

¹⁰³ The Import, Export and Customs Powers (Defence) Act 1939, 2 & 3 Geo. VI, c.69.

¹⁰⁴ Exchange Act 1947 and Strategic Goods (Control) Order 1959.

process and from making law on matters of general policy and principle that depart from parliament's statutory objectives. The proper domain therefore of government lawmaking power in adopting secondary legislation should involve matters of detail regarding the implementation of parliament's broader statutory objectives. The UK enabling legislation, however, can contain provisions that delegate authority to a government minister to adopt secondary legal rules that can change the terms of the enabling statute or some other statute. This type of wide-ranging executive authority can be criticised based on the principle of separation of powers and democratic accountability as expressed through the will of parliament.

The wide discretion of the British cabinet to adopt secondary legislation implementing sanctions can potentially depart from the original statutory objectives of the enabling legislation and thus undermine the statutory policy objectives and legal principles contained in that and other statutory regimes. The potential for ministerial and administrative abuse of authority to adopt secondary legislation imposing sanctions raises another set of issues regarding the scope of judicial review for individuals and businesses to challenge the application of sanctions to them or their transactions. English administrative law provides generally that the exercise of state power can be challenged on substantive and procedural grounds. The availability and effectiveness of judicial review, however, can be substantially restricted – and in some cases eliminated – by enabling legislation that contains wording that authorizes a minister to 'make such regulations as he thinks fit', or by the use of an express 'ouster clause' in the statute that precludes any judicial challenge to the validity of the secondary legislation or regulations adopted pursuant to the act.

The limited scope of judicial review, however, to determine the validity of secondary legislation that implements sanctions policy has been expanded to some extent under the Human Rights Act 1998, which implements into UK law the European Convention on Human Rights, and which requires that those deprived of fundamental rights (e.g., the right to property) be allowed a hearing before a fair and impartial tribunal. The ability to petition the government's decision to freeze one's assets, for instance, has become particularly important for those individuals and businesses whose assets may have been frozen by UK banks because of UK Treasury freeze orders that arise from terrorist designations by the Security Council sanctions committees or the EU Council of Ministers regulations.¹⁰⁵

¹⁰⁵ Under Security Council resolutions and EU regulations that prohibit the financing or other direct or indirect economic support of terrorism, the Treasury has adopted statutory instruments that delegate authority to Treasury officials to impose blocking orders on the accounts and assets of certain designated individuals and firms who have been designated by the Security Council terrorist committees and to impose criminal and civil liability on third parties who assist terrorists or provide them with economic resources. See Terrorism (United Nations Measures) Order 2006 (2006/2657)((implementing SC Resolution 1373 (1)(a)-(c)(2001), imposing asset freeze

Since 2001, the scope of UK financial sanctions regulations has been expanded to include terrorist financing and the third parties who facilitate or assist transactions with terrorists or terrorist organisations. Under EU and UK law, terrorist financing, along with money laundering, has now been included in the definition of financial crime. As discussed in Chapters 6, a vast array of UK legislation applies to financial crime: the Financial Services and Markets Act 2000, the Terrorism Act 2000, the Anti-Crime, Security and Terrorism Act 2001, the Proceeds of Crime Act 2002, and the Serious and Organised Crime Act 2005 (SOCA). These statutes have provided authority for a variety of UK regulatory agencies and professional associations to devise rules, principles and guidance to industry and professionals regarding their responsibilities for disclosing suspicious transactions and conducting due diligence to know their customers.¹⁰⁶ The Law Society of England and Wales has devised rules for solicitors to report suspicious transactions to SOCA involving suspicious transactions with their customers. The Financial Services Authority has devised financial crime regulations that require banks, investment and insurance firms to devise internal controls and information channels that store information about their customers and to investigate the source of wealth of their customers. The UK government has stated that these regulatory rules are crucial in preventing terrorists and their supporters from exploiting British businesses.

In addition, the UK gives effect to the relevant Security Council resolutions and EU regulations that impose blocking orders on the assets of designated terrorists and their supporters and certain states subject to UN

orders against terrorist designated by EC Regulation and the UK Treasury)), and the Al Qaeda and Taliban (United Nations Measures) Order 2006 (2006/2952)(implementing SC Resolution 1452(prohibits the making available of funds and economic resources to Al Qaeda and ex-Taliban officials or their supporters who are designated by the Security Council's Counter-Terrorism Committee)). In *G v. HM Treasury* TLR (12 Nov. 2008), the Court of Appeal ruled that the Terrorism Order and Al Qaida and Taliban Order were lawful and valid provided the Treasury was required to show, under the Terrorism Order, reasonable grounds that the designated person was suspected of involvement in committing or facilitating terrorism, and, under the Al Qaida/Taliban Order, that the designated person was entitled to a merits-based judicial review of any freeze order. Moreover, the court upheld the Treasury's designation of the terror suspects and the freeze orders so long as the Treasury 'has reasonable grounds for suspecting that you are a person who facilitates the commission of acts of terrorism.' The language of the Orders were held to comply with proportionality and legal certainty. The decision overturned the decision of Mr. Justice Collins in the High Court in *A et al v. HM Treasury* [2008] 1 EWHC 869 (Admin), where he ruled that asset freeze orders imposing criminal liability on third parties for supporting terrorists lacked proportionality and legal certainty and could not merely be approved by Order in Council without Parliament approval.

¹⁰⁶ For instance, money services businesses are required by the Proceeds of Crime Act 2002 to report suspicious transactions to the Serious and Organised Crime Organisation (SOCA).

and EU sanctions. The British Privy Council approves Orders in Council to implement UN sanctions measures. For instance, Her Majesty's Privy Council implemented into UK law paragraphs 1(c) and (d) of Security Council Resolution 1373 directed against international terrorists and their financiers by adopting an amended Terrorism (United Nations Measure) Order in 2006.¹⁰⁷ Article 7 of the Order prohibits any dealing with the funds or economic resources that belong to, or are owned or controlled by, listed terrorists or any person owned or controlled, directly or indirectly, by listed persons or any person acting on behalf of or at the direction of listed persons. Article 8 of the Order prohibits the making of funds, economic resources or financial services available to or for the benefit of listed persons. Listed persons are referred to as 'designated persons' in the orders and they could also be senior officials of governments subject to UK sanctions, such as Burma, Belarus and Zimbabwe. Similar Orders apply to designated states, government officials, ex-government officials (e.g., the Taleban) and other terrorist organisations (Hamas). Articles 7 and 8 provide serious criminal liability exposure for third party banks or professionals who manage assets for, or advise or act on behalf of, designated persons.¹⁰⁸

The UK government's economic sanction policy has generally been characterised as being measured and coherent (FCO, 2006). A House of Lords Select Committee, however, was critical of UK economic sanctions when they are used 'as the main means of resolving' disputes in isolation from other foreign policy instruments (House of Lords, 2007, 44–45). In addition, UK sanctions policy has attracted criticism because of the role of the UK Export Credits Guarantee Department (ECGD) in providing subsidised loans and guarantees to UK firms that export to Iran and other countries that have been targeted by UN and EU sanctions.¹⁰⁹ In July 2007, a US Treasury official met with UK officials and criticised UK policy for being inconsistent with UN sanctions.¹¹⁰ The UK has argued that EU member states should do more to enforce sanctions against Iran, but in this case the UK has appeared to contradict its own sanctions policy by continuing to provide export credits to UK firms that invest in the Iranian oil and gas industry. The ECGD programme essentially guarantees bank loans for trade finance that enable foreign purchasers to buy exported products and services, even military

¹⁰⁷ SI 2006/2657.

¹⁰⁸ SI 2006/2657, art. 4 (imposing criminal liability based on an objective knowledge standard). See discussion in Chapter 6.

¹⁰⁹ ECGD provides the following services: (1) Insurance to UK exporters against non-payment by their overseas buyers; (2) Guarantees for bank loans to facilitate the provision of finance to buyers of goods and services from UK companies; (3) Political risk insurance to UK investors in overseas markets.

¹¹⁰ See *The Sunday Times*, Business section p. 7 (18 Nov. 2007) (citing US Undersecretary of Treasury for Enforcement, Stuart Levey, as criticising the consistency of UK sanctions policy towards Iran).

equipment, from UK firms. In 1994, the ECGD ceased its guarantee for UK exporters selling to Iran, but resumed the guarantee programme in 2000. A substantial amount of support has guaranteed the purchase price for UK exporters to sell to the National Iranian Oil Company and the National Petrochemical Company. In November 2007, the UK FCO announced that money earned by the Iranian oil industry was used to support the development of the Iranian nuclear enrichment programme and insurgents seeking to overthrow the Iraqi government. ECGD acknowledges these programmes but stated they were 'completely within the law'.

Moreover, there are problems regarding whether the implementation of anti-terrorist financial sanctions are imposing a disproportionate cost on the UK financial services industry. In recent years, however, it is recognised that the Bank of England and now HM Treasury have taken a 'light touch' approach, in contrast to its US counterparts, by providing banks and financial service firms with clear instructions and guidance that have in most cases minimised compliance costs for the UK financial sector. There is also a concern regarding whether other EU member states have implemented financial sanctions with the same level of intensity as the UK. And finally, there is concern regarding the extent to which UK authorities should recognize US terrorist designations and asset freeze orders which are not recognised by the Security Council.

The case of Southern Rhodesia

British economic sanctions against the former Southern Rhodesia (today Zimbabwe) provide an example of the different approach to sanctions policy that the UK government followed in comparison with the sanctions practices of other leading developed states. The case of Rhodesia provides an interesting case study regarding how the UK government went about imposing economic sanctions against a country with which it had had a long history of close economic and political ties and the role of the UN Security Council and other leading states in adopting sanctions and in deferring to UK authorities to take the lead in devising and implementing the sanctions. Nevertheless, the case of Rhodesia exposed large gaps in the legal and regulatory framework used to implement sanctions and explains in part why the sanctions were not very effective in bringing about political reform. Indeed, this was recognised in a House of Lords Select Committee report in 2007 that observed that '[e]conomic sanctions were not decisive in ending UDI [Rhodesian white rule]. Rhodesia was able, with difficulty, to adapt its economy to the situation, and to organise "sanctions busting" through South Africa and Portuguese colonies of Angola and Mozambique'.¹¹¹ Nevertheless, sanctions did play a significant, but not decisive, role in

¹¹¹ House of Lords Select Committee on Economic Affairs, *The Impact of Economic Sanctions* (9 May 2007) p. 14.

bringing the regime down, but it took thirteen years of UK and UN sanctions to bring this about, and it was only after South Africa decided in 1976 to withdraw its support for the white-controlled Rhodesian government that it decided to implement reforms which led to majority black rule.

The events which led to the United Kingdom imposing sanctions against Rhodesia began in 1964 when the UK granted the request of Nyasaland and Northern Rhodesia for independence according to the procedures which were in use for other ex-colonies, while refusing the request for independence of the white minority-elected government of Southern Rhodesia on the ground that the minority-elected government had failed to allow the black majority of its population to vote or otherwise exercise full rights of citizenship (de Smith, 1965). For two years, negotiations took place between the governments of Britain led by Prime Minister Harold Wilson and Southern Rhodesia led by Prime Minister Ian Smith. Both parties sought a formula for independence plus guaranteed integration of the majority into political power. After negotiations reached impasse, on 11 November 1965, the government of Southern Rhodesia issued a 'Unilateral Declaration of Independence' (UDI) for the new state of Rhodesia.¹¹²

After the UDI government came to power, however, it became clear within a short time that the white minority government could not gain international acceptance for its attempt to establish an independent nation. The British responded to the UDI by announcing two initiatives involving the implementation of multilateral and unilateral economic sanctions. First, Britain announced that it would assume full authority over the government in Rhodesia and adopted strict economic sanctions and political controls affecting Rhodesia and those who dealt with it.¹¹³ Second, the British government called for a meeting of the Security Council and asked for the active support of the Council and all members of the United Nations for the use of economic sanctions against Rhodesia.¹¹⁴ After the UN Security Council approved international sanctions, the Cabinet issued further orders in late 1965 under the Import, Export and Customs Powers Act 1939 to prohibit all imports and exports to Rhodesia.¹¹⁵

British sanctions differed in their scope of application in comparison with US sanctions in two respects: (1) the British did not attempt to apply their

¹¹² The UDI paraphrased much of the American Declaration of Independence, though it omitted the important phrase that: 'All men are created equal. ...' The complete text of the Rhodesian Declaration of Independence is reproduced in Lowenfeld (1983, App. DS-716).

¹¹³ Southern Rhodesia Act 1965, c.76, s.1. The Act stated that: 'Southern Rhodesia continues to be a part of her Her Majesty's dominions, and that the Government and Parliament of the United Kingdom have responsibility and jurisdiction as heretofore for and in respect of it'.

¹¹⁴ See statement of the then British Foreign Minister, Michael Stewart, before the UN Security Council, 20 UNSCOR 1257 3-8 (1965).

¹¹⁵ (1965) 9 & 10 Geo. VI, c.45, s.1.

sanctions extra-territorially against UK-controlled third country persons, presumably because the UN sanctions would be applied; and (2) the British undertook to legislate directly in and for the target country on the basis that 'Southern Rhodesia continues to be a part of Her Majesty's dominions, and that the government and Parliament of the United Kingdom have responsibility and jurisdiction'.¹¹⁶ On the basis of the power conferred by Parliament, the British Government issued an Order in Council invalidating all laws adopted by the Southern Rhodesia legislature after 11 November 1965, and authorising legislation by Order in Council to invalidate all laws of Southern Rhodesia that affect external and internal affairs of Southern Rhodesia.¹¹⁷ These orders established the jurisdictional basis for legislation concerning Rhodesia; and Parliament authorised the delegation of rule-making authority to the government of Prime Minister Wilson, which in turn adopted a series of economic measures.

First, the UK government suspended the Commonwealth Sugar Agreement as to Rhodesia and all imports of sugar were banned.¹¹⁸ The government then denied Commonwealth preferences to the products of Southern Rhodesia,¹¹⁹ and shortly thereafter the list of embargoed items was expanded to include asbestos, coffee, iron and steel, chromium and meats. Prime Minister Wilson stated that by early December 1965 95 per cent of Rhodesia's exports to Britain had been proscribed.¹²⁰ Second, the government imposed an embargo on all military exports from Britain to Rhodesia, but other exports were permitted. Moreover, the government ceased all further guarantees of credit to be made by the British Government to exporters seeking Rhodesian markets.¹²¹

British financial sanctions against Southern Rhodesia

The UK imposed a number of financial sanctions that either restricted or prohibited the export of capital from Britain to Rhodesia, imposed controls on current transfers from Britain to Rhodesia, and excluded Rhodesia from the sterling area.¹²² Later, during the late 1960s and early 1970s, under authority of the Exchange Control Law 1947, the government tightened financial controls to prohibit practically all current payments to Rhodesia, and to block the accounts in the territorial jurisdiction of the United Kingdom of all Rhodesian nationals who had been receiving dividends and interest in financial accounts. Further, UK residents were prohibited from engaging in export-import transactions in goods between

¹¹⁶ Southern Rhodesia Act 1965, c.76, s.1.

¹¹⁷ The Southern Rhodesia Constitution Order, 1965, s.3.

¹¹⁸ S.I. No. 1953 (1965).

¹¹⁹ S.I. No. 1954, (19 Nov. 1965), amended by S.I. No. 1987 (1965).

¹²⁰ Many of these measures were not implemented initially by statutory instruments but by directives issued by the Board of Trade and the Treasury Department.

¹²¹ Export of Goods (Control) (Amendment) Order 1966, S.I. No. 71 (1966).

¹²² See S.I.s. Nos. 5796, 5797, 5799, 6029, 6070, 6072 (1965); S.I. No. 223 (1966).

Southern Rhodesia and countries outside the sterling area.¹²³ All of these controls covered transactions in the UK or by residents of the UK. In addition, the British government began to exercise its authority granted in the Southern Rhodesia Act to prohibit exports and imports to and from Rhodesia itself; this applied first to oil,¹²⁴ then to chrome and chromite and then on to a series of other products.¹²⁵ Unlike the US, however, the British did not seek to enforce these economic sanctions against third country persons trading with Rhodesia, nor did it seek to impose the sanctions or controls against foreign subsidiaries of UK companies which may have been trading in violation of these orders; but the British government, as stated by Prime Minister Wilson, expected that other nations, including the US, would consider contracts in violation of the orders unlawful and unenforceable.

Later, the British government confronted many similar problems in applying targeted sanctions against Zimbabwe in the early 2000s. UK sanctions against Zimbabwe which were lifted in September 2008 after a power-sharing agreement was reached between President Robert Mugabe and the elected Prime Minister Morgan Tsvangirai imposed prohibitions on UK companies doing business with Zimbabwe and imposed blocking orders and travel bans on certain senior officials in Mugabe's government. Nevertheless, some UK companies continued to trade with Zimbabwe through subsidiaries which were incorporated in other jurisdictions, such as South Africa. The UK sanctions measures did not apply extra-territorially to these UK-owned foreign subsidiaries nor did they restrict the UK parent company from directing its subsidiary not to trade with Zimbabwe. These problems of inadequate legal technique and regulatory practice have undermined the effectiveness of British economic sanctions over the years. Nevertheless, UK sanctions measures usually are based on a set of clearly defined policy objectives as set forth in Security Council resolutions¹²⁶ and/or European Community Regulations and EU positions on the Common Foreign and Security Policy. As a result, despite weaknesses in certain areas of legal technique and the oversight of UK-based multi-national companies, UK sanctions policy generally has been successful in many of its objectives and imposing significant costs on sanctions targets.¹²⁷

¹²³ The Southern Rhodesia (Prohibited Exports and Imports) Order, S.I. 1966 (20 Jan. 1966)

¹²⁴ The Southern Rhodesia (Petroleum) Order 1965, S.I. No. 2140 (1965), *amended* by S.I. No. 2168, (1965).

¹²⁵ Southern Rhodesia (Prohibited Exports and Imports) Order 1966, (20 Jan. 1966).

¹²⁶ See Emergency Powers, the Control of Gold, Securities, Payments and Credits (Kuwait), S.I. No. 1591 (2 Aug. 1990); See *ibid.* (Iraq) S.I. No. 1616 (4 Aug. 1990), and S.I. No. 1651 (8 Aug. 1990).

¹²⁷ House of Lords Select Committee on Economic Affairs (2007, pp. 18–19), however, has taken a different view by criticizing UK sanctions for not having clearly

III Japan

Although the Japanese government had traditionally been hesitant to impose economic sanctions outside Security Council requirements (Miyagawa 1992, 31–33), it began to follow a more assertive and unilateral economic sanctions policy in 2006 as a response to North Korea's launching of missiles over its territory in 1998 and again in 2006 and its failure to account for kidnapped Japanese nationals (Miyamoto 2006, 22–25). The Japanese government's legal authority to impose sanctions derives from three statutes: the Foreign Exchange and Foreign Trade Control Law (FECL), the Law for Special Measures Concerning Interdiction of Ports Entry by Ships (LMCIP), and the Export and Import Transactions Law (EITL). The two most frequently used are the FECL and LMCIP (Ibid). The FECL is linked to previous trade legislation that provided for an extensive system of administrative rules to provide guidance for implementing economic sanctions. This 'administrative guidance' in matters concerning foreign trade control is an established feature of Japanese trade policy; it encompasses a range of measures by which various ministries are able to influence voluntary compliance by private entities (Miyagawa, 1992).

The FECL was enacted in 1949 and served as the fundamental law governing Japanese foreign trade (Miyamoto 2006, 25). It authorised the relevant ministry officials to restrict or prohibit transactions involving the import or export of goods or transactions involving foreign exchange and investment. Although the law provides the relevant ministries with discretion to impose economic controls, the law's primary objective is to promote a stable balance of trade and to achieve 'sound development of the national economy' (Matsushita, 1990). Indeed, Miyamoto (2006, 25) observes that the FECL was adopted at a time when Japan suffered from a serious foreign exchange shortage and that it was necessary for trade officials to use administrative rules to maintain a balance of trade so as to enable Japan to stay within its fixed exchange rate currency parities under the Bretton Woods system. Article 47 of the law, however, recognizes a citizen's right to export by stating that the '[e]xport of goods from Japan shall be permitted with the minimum restrictions thereon consistent with the purpose of this Law' (Ibid). This right to export was upheld by the Tokyo District Court in 1969 when it ruled that the then Ministry of International Trade and Industry's (MITI) authority to enforce its obligations with its allies under the CoCom export control regime was outside of the scope of the FECL and it infringed on the constitutional liberty to export (Ibid). This case and the law's recognition of a citizen's freedom to export suggest that the Government's

defined objectives and imposing significant collateral damage on non-target civilians.

authority to control exports is more limited than its power to restrict imports.

The FECL also contained an important provision that was interpreted as imposing a pre-condition to Japan's imposing economic sanctions to situations where Japan acknowledges the need to fulfil treaty obligations 'and other international promises concluded with Japan' or when the Japanese government 'acknowledges that Japan needs to contribute to international efforts for world peace.' (Miyamoto, 25). The Japanese Diet, however, amended the legislation in 2004 to give the Japanese Cabinet more authority to impose sanctions on a unilateral basis to meet Japan's security needs even when the imposition of sanctions was not authorised or required by international agreement or as part of international efforts to achieve peace and security (Ibid).

The second law, entitled the Export and Import Transaction Law (Export Law), serves as authority for the government to impose economic controls, specifically, to adjust prices and quantities of exports where there are foreign export agreements, and to issue import orders in certain situations.¹²⁸ The other significant economic sanctions legislation is the Law for Special Measures Concerning Interdiction of Ports Entry by Ships (LMCIP) which also allows Japan to impose unilateral sanctions to promote 'the maintenance of peace and safety in Japan' (Miyamoto, 25). Article I of the LMCIP authorises the Japanese government to restrict or prohibit the entry of specific ships in its ports. The Japanese Cabinet used this authority in 2006 to prohibit the North Korean ship *Man Gyong Bong 92* from entering Japanese port because of suspicions that Korean workers who used the boat were transferring currency to North Korea without complying with Japanese currency exchange regulations. The law also authorises Japanese officials to impose sanctions autonomously under the statute. The 2004 amendments to the FECL and the LCMIP are viewed as necessary statutory measures to provide the Japanese government with the necessary flexibility to adapt their economic sanctions instruments to specific security problems. The previous policy of relying on UN sanctions requirements to determine the use of Japanese sanctions is now viewed as an ineffective policy that did not directly address Japan's national security concerns.

The primary ministry responsible for administering economic sanctions under these laws is the Ministry of Finance whose controls are imposed

¹²⁸ *Yushutsunyu torihiki ho*, as amended, Law No. 299 of 1952. Although MITI was the original ministry responsible for enforcement, it was dissolved in the early 2000s and its powers allocated to several Japanese ministries. The Ministry of Trade and Commerce now has responsibility for overseeing and enforcing the Export Law. It has a policy mandate to exercise its oversight function and enforcement powers for export controls and other trade restrictions by scrutinising private trading agreements, and to take action when these agreements produce results which may be harmful to the Japanese economy (Miyagawa, 1992, 38).

through administrative guidance orders, which are based on statutory authority. In the area of private credit and lending, Japan has co-ordinated its foreign policy closely with its large private banks. The Japanese government's frequent and continuing use of administrative guidance has given the government a highly effective means of informally influencing Japanese banks's overseas business behaviour. By relying on statutory authority and administrative guidance orders, the Japanese government has the regulatory flexibility to use economic sanctions to achieve foreign policy and national security objectives. For instance, Japan adopted limited sanctions against Iran in 1979 during the US hostage crisis by agreeing not to buy Iranian oil on the spot market and to restrict its total imports of Iranian oil to pre-hostage levels (Kern, 1983). Japan, however, refused to relinquish its role in the Iran-Japan Petrochemical Company, a two-billion-dollar capital project that was 85 per cent complete in 1980; and it refused to restrict its banks and finance companies from financing transactions involving US dollars with Iran, which enabled Iran to circumvent the US freeze orders against Iranian assets (Ibid.). In other cases, however, Japan has co-operated in imposing financial sanctions against certain targeted states. In 1979, Japan responded to the Soviet invasion of Afghanistan by restricting credit to the Soviet Union and the export of capital machinery and high technology. Japan also boycotted the 1980 Moscow Olympics and restricted the exchange of trade personnel (Ibid.). In the case of Iraq in the 1990s and pursuant to UN Security Council resolutions, the Japanese Government imposed sanctions that included a trade embargo and a suspension of all financial transactions with the Iraqi government and Iraqi persons.¹²⁹

More recently, Japan has used both positive and negative sanctions to influence the North Korean government to cease uranium enrichment and plutonium development and to cease missile testing in the Pacific region. In doing so, Japan has recognised the importance of offering economic co-operation and support, along with the possibility of normalising diplomatic relations, if North Korea complies with UN Security Council 1737 which requires it to cease plutonium development and to allow IAEA inspectors to verify compliance. Japan has signalled that it might provide economic support in the form of government aid, long-term loans with low interest rates, and humanitarian assistance provided through international organisations.¹³⁰ Japan has also suggested that it would seek to influence North Korean behaviour by providing loans and credits through the Japanese Bank for International Co-operation that would support the development of private sector economic activities in

¹²⁹ MOF Ord. No. 134, Amendment of Foreign Exchange and Foreign Trade Control Law (10 Aug. 1990).

¹³⁰ See statement of the Japanese Ministry of Foreign Affairs, 'Japan-DPRK Pyongyang Declaration' 17 September 2002.

North Korea.¹³¹ This policy of using the 'carrot approach' to induce North Korea to respect Japan's security concerns appeared to have borne fruit in 2002 when North Korea agreed to a bilateral non-binding agreement with Japan that it would not conduct military testing that would threaten the 'lives and security of Japanese nationals'.¹³²

In June 2006, however, North Korea launched missile tests which prompted Japan to impose nine sanctions measures against the country. The sanctions took a variety of forms including a six-month embargo on port calls in Japan by the North Korean vessel the *Man Gyong Bong - 92*, which had provided the only regular passenger service between the two nations. The government also banned entry into Japan of North Korean government officials and postponed indefinitely all planned trips to North Korea by Japanese government officials and cancellation of all chartered flights between the two nations. Other sanctions measures included enhanced export control procedures of dual use items that could be used for both civilian technology and military purposes.

Following Japan's announcement of the sanctions measures, North Korea launched its seventh missile.¹³³ The Japanese government responded by threatening tougher measures that would impose further restrictions based on existing laws that could result in outright bans on all trade and money remittances to North Korea. Moreover, then Prime Minister Koizumi said Tokyo would continue to urge Pyongyang to abide by the 2002 Declaration that contained a moratorium on missile launches. Koizumi emphasised that any sanctions measures should leave room for dialogue.

In addition, Japan is a member of the so-called six-party talks between North Korea and Japan, China, the US, Russia and South Korea that has put pressure on North Korea to cease development of weapons of mass destruction and to maintain a moratorium indefinitely on missile tests. When North Korea resumed missile tests in the Pacific Ocean in October 2005, Japan terminated foreign exchange dealings with North Korea which severely curtailed trade between the two countries and suspended remit-

¹³¹ An important premise of Japanese-North Korean negotiations over normalisation of relations involves both countries agreeing to a mutual waiver of all their property claims and the claims asserted on behalf of their nationals against the other country that arose from actions that occurred before 15 August 1945. See 'Japan-DPRK Pyongyang Declaration'.

¹³² Ibid.

¹³³ 'Japan slapping sanctions on Pyongyang', *The Asahi Shimbun* (2006). The then Chief Cabinet Secretary Shinzo Abe stated that '[w]e are considering all possible means of sanctions that Japan is capable of imposing'. Abe later said that '[t]he firing of the missiles constitutes grave problems from the standpoint of our national security, peace and stability of the international community as well as from the standpoint of non-proliferation of weapons of mass destruction', and that 'Japan would take severe measures'. Ibid.

tances of North Koreans working in Japan to relatives or others in North Korea. Moreover, Japan has supported US efforts to combat North Korea's involvement in economic crime and terrorist financing by imposing extra-territorial blocking orders against US dollar accounts held by foreign banks in third countries on behalf of North Korean entities.¹³⁴ Moreover, both countries have decided to discuss the status of Korean residents in Japan and the issue of cultural property and ongoing disputes involving Japanese citizens who were kidnapped by North Korean forces during World War II and not allowed to return to Japan following the war.

Although Japanese sanctions appear to have achieved some of their objectives as evidenced in the results of the six-party talks in which North Korea announced that it would end uranium enrichment and plutonium development in return for economic assistance and civilian nuclear power support, the limitations of this policy were exposed in June 2007 when North Korea launched a test missile in the Pacific despite earlier commitments in the 2002 agreement to end this activity. In October 2007, however, North Korea allowed inspectors from the International Atomic Energy Agency to inspect its plutonium plant at Yongbyon and they confirmed that the North Koreans had begun dismantling the plant. Although recent North Korean intransigence has stalled progress in this area, the Japanese sanctions against North Korea as part of the six-party talks and regional sanctions initiative have borne fruit and are expected to bring more progress with North Korea in the future.

IV The European Union

The European Union¹³⁵ (EU) has express authority to impose economic sanctions either unilaterally or by implementing binding Security Council

¹³⁴ US financial sanctions under the Patriot Act against North Korea will be discussed in Chapter 10 along with the recent decision of North Korea to cease uranium enrichment and plutonium development in return for obtaining access to blocked US dollar accounts held by Banco Delta Asia in Macao.

¹³⁵ The Treaty on European Union (1992) (Maastricht Treaty) created the European Union in 1993 as an over-arching structure that linked the three European Communities to the new areas of common activity – the Common Foreign and Security Policy (CFSP), and Justice and Home Affairs (JHA). The European Communities had been technically three international organisations consisting of the European Coal and Steel Community (ECSC) (Treaty of Paris 1951), and the European Economic Community (EEC) and European Atomic Energy Community (Euratom) (Treaties of Rome 1957). Over the years, there was increasing integration of the Communities. In 1965, a single Council and Commission were established to govern the Communities. Treaty Establishing a Single Council and a Single Commission of the European Communities (Merger Treaty 1967). In 1986, the Conference of the Representatives of the Governments of the Member States adopted the Single European Act, which included treaty modifications concerning foreign policy co-ordination as well as community institutions, monetary co-operation,

resolutions.¹³⁶ EU officials usually refer to unilateral sanctions as ‘autonomous sanctions’ and have adopted autonomous sanctions on an increasing basis in the 1990s and 2000s (House of Lords Select Committee, 2007, 21). EU autonomous or unilateral sanctions were imposed against the Heads of State of Belarus and Zimbabwe in early 2000s and against Burma in 2003.¹³⁷ These EU sanctions have been different in design and purpose than the multilateral sanctions that the UN Security Council applied in the 1990s against Iraq, Haiti and the former Yugoslavia. The UN sanctions were intended to cripple the economies of those countries in order to bring pressure on the political regimes to comply with Security Council resolutions, while EU sanctions have normally taken the form of targeted or ‘smart’ sanctions – that is, asset blocking orders or travel bans against particular individuals or companies. EU autonomous sanctions have attracted criticism recently for failing to provide clear procedures and transparent criteria for individuals listed as terrorists to be de-listed and for determining whether EU sanctions are effectively bringing about changes in the policies of targeted states (Ibid, 25).

History of EC sanctions practice

Before the Maastricht Treaty took effect in November of 1993, however, there was no express authority in the Treaty of Rome providing for a Community competence in economic sanctions. The absence of such express authority, however, did not prevent the Council of Ministers from issuing regulations implementing UN embargo resolutions.¹³⁸ The legal

research and technology, environmental protection, and social policy. 25 *ILM* 503 (May 1986). In 1992, the Maastricht Treaty created the EU consisting of three pillars: 1) the European Community, which absorbed the three Communities, 2) the CFSP, and 3) JHA. The Treaty of Amsterdam (1997) laid the basis for EU enlargement and restructured the JHA pillar into Police and Judicial Affairs. The ECSC treaty had a 50 year limit which lapsed in 2002 and the EC took over its activities. The Treaties of Amsterdam and Nice (2001) expanded the power of the European Parliament to that of the Council and extended the co-decision procedure to most EC policy areas. The Treaty of Lisbon (2008) abolishes the pillar structure and merges the EC pillar with the others into a single EU with separate legal personality.

¹³⁶ See Articles 301 (ex-Article 228A) and 60 (ex-Article 73G), Treaty Establishing the European Community, as Amended by Subsequent Treaties (25 March 1957; Treaty of Rome). The Treaty on European Union (1993) sets out the framework of the Common Security and Foreign Policy (CSFP) that empowers the EU to impose sanctions or restrictive measures to promote foreign policy objectives.

¹³⁷ See EU Council Common Position 2006/318/CFSP, 27 April 2006 (Burma).

¹³⁸ See SC Res. 661 (1990; Iraq & Kuwait), *implemented by* EC Regs. 2340/90 (1990) *OJ* L213/1 & 3155/90 (1990) *OJ* L304/1. See also SC Res. 748 (1992), *implemented by* EC Reg. 945/92 (1992) *OJ* L101/53 (Libyan embargo on aircraft and component parts and services); SC Res(s). 757 (1992) & 820 (1993), *implemented by* EC Regs. 1432/92 (1992) *OJ* L151/4 & 990/93, (1993) *OJ* L102/14 (imposing comprehensive commercial and

basis for such authority was Article 133 (ex-Article 113) of the Treaty of Rome which provides for 'implementing a common commercial policy'¹³⁹ and gives the Community competence to pre-empt member state measures in the same area (Pavoni, 1999, 588). Hence, import and export restrictions and non-financial services have been held to come within the ambit of Article 133.¹⁴⁰ But the Commission did not interpret Article 133 as authorising financial sanctions. EU member states were thus free to adopt financial sanctions if they did not conflict with EC policy or if they were pursuant to UN economic sanctions resolutions.

In addition, the EC relied on Article 80 (ex-Article 84), in conjunction with Article 133, to adopt transport sanctions against Iraq, Libya and Serbia-Montenegro¹⁴¹ pursuant to UN Security Council resolutions. The EC also utilises Article 308 (ex-Article 235) as a residual basis for action allowing the Council to take 'appropriate measures' if action by the Community is necessary to attain one of the Community's objectives and the EC Treaty has not provided the necessary powers.¹⁴² In fact, the EC relied on the implied powers clause of Article 308 to implement paragraph 29 of Security Council Resolution 687 (1991), by which the Security Council called upon all states to prohibit the satisfaction of claims based on the non-performance of contractual obligations whose execution has been affected by the UN embargo against Iraq.¹⁴³

Articles 223 and 297 (ex-Article 224) provide further authority for sanctions to be imposed at different levels of the Community. Article 223 provides a specific basis for EC sanctions involving 'trade in arms, munitions and war material'. In contrast, Article 297 (ex-Article 224) unequivocally

financial sanctions against Serbia and Montenegro (Federal Republic of Yugoslavia and Bosnian Serb territory).

¹³⁹ Article 133 states that 'the common commercial policy shall be based on uniform principles, particularly in regard to changes in tariff rates, the conclusion of tariff and trade agreements, the achievement of uniformity in measures of liberalization, export policy and measures to protect trade such as those to be taken in case of dumping and subsidies'. The full scope of the EC's broad powers under article 133 remains 'undetermined and controversial'. because the term 'common commercial policy' is not defined in the Treaty of Rome.

¹⁴⁰ The European Court of Justice gave Article 113 (now Art. 133) a broad interpretation in *Opinion 1/78* [1979] ECR 2871, para. 45; see also *Opinion 1/94* [1994] ECR I-5267, paras. 31, 39.

¹⁴¹ EC Reg. 3155/90 (1990) *OJ* L304/1 (Iraq); EC Reg. 945/92 (1992)*OJ* L101/53 (Libya); EC Reg. 1432/92 (1992) *OJ* L151/4.

¹⁴² Article 308 provides:

If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the Assembly, take the appropriate measures.

¹⁴³ EC Reg. 3541/92 (1992) *OJ* L361/1.

grants EU member states competence to adopt national laws unilaterally without EC regulatory authority in order to implement Security Council sanctions. It states:

Member States shall consult each other with a view to taking together the steps needed to prevent the functioning of the common market being affected by measures which a Member State may be called upon to take in order to carry out obligations it has accepted for the purpose of maintaining peace and international security.

Member States are required, however, to consult with one another in deciding whether to implement Security Council sanctions on an individual basis.

EU unilateral economic sanctions

The EU has adopted autonomous or unilateral economic sanctions outside the scope of the UN sanctions regime and independent of any other multi-lateral commitments on various occasions in recent years. Historically, Article 133 (ex-Article 113) was cited as authority for the Council of Ministers and the Commission to adopt unilateral sanctions against Argentina, Iran, and the Soviet Union (Kuyper, 1982, 141).¹⁴⁴ Indeed, after the British government adopted comprehensive sanctions against Argentina, including a freeze on Argentinian assets located within British territory or under the control of British nationals, the Council of Ministers voted unanimously in April 1982 to impose a temporary import ban through a regulation based on Article 133 (ex-Article 113).¹⁴⁵ Although there were major loopholes in the ban which diminished its effectiveness, the EC decision and the basis for it were correctly viewed as an important precedent for future crises (Kuyper, 1982, 147–151).

The EC has the power to limit the ability of its members to impose unilateral economic sanctions against both member and non-member countries. Indeed, the Treaty of Rome prohibits export or import controls between the Member States, as well as restrictions on private credit flows for foreign policy reasons.¹⁴⁶ Some have argued that the language in Articles 28–31 not only confers powers on the European Community to control imports but also restricts the discretion of Member States in imposing controls against non-EU states (Carter 1987, 224–225). According to this argument, a Member State may only impose import controls in certain circumstances where the EC has not

¹⁴⁴ 29 *OJ Eur. Comm.* (No. L 268) I (1986); 29 *OJ Eur. Comm.* (No. L 305) 11, 45 (1986).

¹⁴⁵ See 25 *OJ Eur. Comm.* (No. L 102) I (1982).

¹⁴⁶ Treaty of Rome, arts. 28–31 (free movement of goods – elimination of quantitative restrictions), and 56–60 (free movement of capital).

enacted directives or regulations pre-empting a specific area. For example, the United Kingdom's ban on the import of diamonds from South Africa in the 1980s was not pre-empted because there were no EC regulations which had been enacted against South Africa thereby permitting EU member states to enact their own import controls. The effectiveness, however, of the UK prohibition was undermined by the fact that the UK could not prohibit the importation of diamonds from South Africa by way of another EC state.

The Treaty of Rome's prohibition on import controls against another Community member state applies both to products originating in that country and to products coming from third countries that have cleared customs in a Member State.¹⁴⁷ The possibilities of indirect trade thus make any unilateral import control relatively ineffective, depending on the costs of transshipment. Similarly, though there have been no EU cases decided on point, EU law probably does not prohibit unilateral controls over exports to a third country or over private credit transactions with third country entities. Some questions, however, might be raised under Articles 133 (ex-Article 113) concerning what has become a 'common foreign and security policy' and under Article 297 (ex-Article 224) requiring consultation amongst Member states.¹⁴⁸

In describing EU authority, it is important to appreciate how the EU usually proceeds in determining whether to impose economic sanctions. The initial discussions amongst the Foreign Ministers in the Council of Ministers usually focus on the steps to be taken and also on choosing 'between a true Community approach or a perhaps coordinated but separate implementation' of measures. When these measures are adopted, the Community documents are sometimes vague about the specific legal authority imposing such measures. One of the reasons for this is that the European Commission and Council of Ministers can choose among the legal vehicles through which to implement sanctions measures. The decision to implement a regulation or directive has a substantive impact on the way a measure is implemented in the Member States.¹⁴⁹ For example, in the case of South

¹⁴⁷ Treaty of Rome, art. 9(2). Article 10(1) provides: 'Products coming from a third country shall be considered to be in free circulation in a Member State if the import formalities have been complied with and any customs duties or charges having equivalent effect which are payable have been levied in that Member State...'

¹⁴⁸ See Treaty of Rome, arts. 110–116 (common commercial policy) and art. 224 (consultation), discussed below. See also Title III (co-operation in foreign policy) of the Single European Act.

¹⁴⁹ Article 249 provides for regulations, directives, decisions, recommendations and opinions. It reads:

'A regulation shall have general application. It shall be binding in its entirety and directly applicable to all Member States'. Further, it states: 'A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods....A decision shall be binding in its entirety upon those to whom it is addressed.'

Africa, the foreign ministers of EU Member States agreed to proceed on the basis of Article 133 (ex-Article 113) by adopting a ban on imports of gold coins, iron and steel as part of a sanctions policy to protest South Africa's apartheid system.¹⁵⁰ Later, the EC Council decided to ban South African imports of iron and steel pursuant to its authority under the European Coal and Steel Community (ECSC) Treaty, rather than under Article 133 (ex-Article 113) of the EC Treaty.¹⁵¹

The Treaty on European Union (Maastricht Treaty)

The Maastricht Treaty added two new articles to the Treaty of Rome regarding Community powers in the area of economic sanctions. These provisions are Articles 301 (ex-Article 228A) and 60 (ex-Article 73G). Article 301 states:

Where it is provided, in a common position or in a joint action of the Treaty on European Union relating to the Common Foreign and Security Policy, for an action by the Community to interrupt or to reduce, in part or completely, economic relations with one or another third countries, the Council shall take the necessary urgent measures. The Council shall act by a qualified majority on a proposal from the Commission.

Article 60 extends the authority granted in Article 301 to include 'measures on the movement of capital and on payments'. These articles providing for a common foreign and security policy have strengthened the legal basis supporting EC competence to impose economic and financial sanctions. Although some states continue to contest the EC's authority to impose financial sanctions under Article 60, the EC relied on Article 60 to adopt Regulation 2471/94 to impose sanctions that froze Bosnian-Serb assets in European financial institutions in the 1990s, as envisaged in Security Council Resolution 942 (1993). Moreover, the Maastricht Treaty does not prohibit member states from continuing to enact their own national laws that impose sanctions based on mandatory Security Council resolutions. Member States are also free to adopt their own national sanctions laws against non-EU states insofar as such sanctions do not conflict with express EC policy.

In 2004, the Council of Ministers adopted a set of principles to inform the use of EU sanctions measures that include that sanctions must be targeted against state and non-state targets and their impact must be adjusted to

¹⁵⁰ Council Reg. (EEC) No. 3302/86, 27 Oct. 1986 in *OJ Eur. Comm.* (No. L 305) II (1986). The regulation exempted 'import documents issued and contracts concluded before the entry into force of this Regulation'.

¹⁵¹ At the time, ECSC Treaty had governed competence over such products; however, the ECSC Treaty expired in 2002 and the competence for regulating commercial policy for coal and steel products was transferred to the European Community.

reduce as much as possible social costs on the broader economy or unnecessarily impose restrictions on third or other related parties. Sanctions must respect human rights and fundamental freedoms as defined in the case law of the ECJ and the European Court of Human Rights and respect treaty obligations. Significantly, the EU has stated that it will 'refrain from adopting legislative instruments having extraterritorial application' and there shall be an expiry or review clause for all sanctions measures. Although these principles are legally non-binding, they provide an important principled-basis for the application of sanctions measures.

Regarding the sanctions policies of other countries, some general comments follow. Before the collapse of the Soviet Union in 1991, the former USSR maintained a comprehensive system of economic sanctions and export controls against both market economies and some communist states. The former USSR often imposed sanctions against recalcitrant satellite countries in order to maintain its direct political control. The Russian Federation presently maintains economic sanctions and strict export controls on civilian goods and services against many of the newly independent states of the former Soviet Union (Drezner, 1999, 131–152). The more draconian of these sanctions laws are directed against former Soviet republics which are now independent such as Georgia, with whom Russia had military conflict in 2008. During the Georgian conflict, Russia restricted imports from Turkey and other countries in the Black Sea region who were continuing to trade with Georgia during the conflict. Russia has since lifted those controls but maintains an embargo against Georgia. Also, Russia has applied limited economic sanctions against former eastern bloc countries in east Europe, most notably Poland.

Similarly, the Arab League and its member countries resorted to sanctions on many occasions between 1945 and 2007. The Arab League has maintained a boycott of trade with Israel since the 1960s. The scope of the boycott is broad, covering all petroleum products and related energy products and extending to individuals and entities outside the Arab League who do business with Israel. An extensive literature has developed analysing the Arab League boycott of Israel, which contains many exemptions today, and will not be further discussed in this study (Doxey, 1980, 59–71).

V The Challenge of Multilateral Sanctions – Lessons Learned

According to Article 25 of the UN Charter, states have the obligation to implement sanctions measures pursuant to Article 41, which obligation they actually perform according to the requirements of their national legal system. In this respect, different countries may have different processes in regard to implementing international obligations in their municipal law.¹⁵²

¹⁵² See discussion of monism and dualism under public international law. See Pavoni (1999, 585–586).

One of the major weaknesses of the UN and British sanctions against Southern Rhodesia and later Zimbabwe was the failure of member states to adopt more flexible concepts of control liability that would hold UK parent companies and investors liable for the sanctions-busting trading and investments of their subsidiaries operating in other countries which were not effectively enforcing Security Council sanctions requirements. Indeed, leading Dutch, French, UK and US-controlled corporate groups exploited the doctrine of separate legal personality between the corporation and its controlling shareholders to evade Security Council sanctions requirements.

As discussed above, the UN sanctions, although multilateral in theory, depended for their implementation on the national sanctions practices of UN members states. The failure of the major states, including Britain and the United States, to implement sanctions regulations in a manner that would combat systematic evasion by multinational corporate groups rendered the international sanctions effort ineffectual. Although states had the obligation to implement sanctions measures pursuant to Article 41, they discharged these obligations in a manner that reflected the different requirements of their own national legal systems. Indeed, an important legal issue was the extent to which parent companies and their affiliates should be held liable for the activities of their subsidiaries.

The lack of an effective control liability regime allowed the major petroleum conglomerates to utilise various subsidiaries purposively to evade the international sanctions embargo. This was evidenced by the activities of the five major petroleum multinationals that had supplied Rhodesia.¹⁵³ The Bingham Report 1978 documented how they each owned 100 per cent of their Rhodesian subsidiaries, which bore their name. They also owned corresponding subsidiaries in South Africa that supplied Southern Rhodesia with over 90 per cent of its petroleum needs (Ibid.). Although the parent companies had agreed with the British and US governments not to supply oil to Rhodesia, their marketing and distribution subsidiaries in South Africa soon began to sell oil to the Rhodesian government through a semi-secret state purchasing agency, GENTA. For example, Shell (Middle East) supplied oil through the Shell/BP refinery in Durban, South Africa and, in turn, to Shell/BP Marketing (South Africa), a company owned by Royal Dutch Shell and British Petroleum but controlled by local South African directors (Ibid., 10–11). Shell/BP Marketing then sold refined products to many customers in South Africa, including GENTA, which transported the products to Rhodesia

¹⁵³ UK Foreign and Commonwealth Office, *Report on the Supply of Petroleum and Petroleum Products to Rhodesia* (London, 1978), 296. T.H. Bingham, Q.C. (now Lord Bingham of the House of the Lords) and S.M. Gray, a chartered accountant, conducted the inquiry. The five companies were Shell Rhodesia 39.1 per cent, BP/Rhodesia 12.9 per cent, Mobil Oil Southern Rhodesia 20 per cent, Caltex Oil Rhodesia 20 per cent, and Total Rhodesia 8 per cent, *ibid.*

by truck or rail. Once the products reached Rhodesia, GENTA sold them to Shell/BP Marketing (Rhodesia), a subsidiary jointly owned by Shell/BP and with Rhodesian officers and directors, which distributed the petroleum products to vendors. This complicated chain of supply concealed any direct link between crude supplies in South Africa and product sales in Rhodesia.¹⁵⁴

Although top-level management of the parent companies denied any knowledge about the 'sanctions busting' activities of their wholly owned subsidiaries, it became increasingly evident that the parent companies knew about these activities and had directly participated. When it became apparent that the oil embargo was failing, critics in Great Britain and the US alleged a major conspiracy.¹⁵⁵ Instead of conspiracy, however, the major problem was that the legal regimes of the parent companies generally did not create parent company liability for the trading and investment activities of their wholly and partially owned subsidiaries and other controlled entities operating in jurisdictions which were not enforcing UN security council sanctions.¹⁵⁶ This loophole was significant because it allowed UK multinationals to circumvent the sanctions regime by shifting its Rhodesian trade to wholly owned subsidiaries that were incorporated in South Africa or other third countries. Essentially, the technical rules of jurisdiction and corporate entity theory protected UK-controlled multinationals from liability under UK sanctions law.

Similarly, although US economic sanctions had imposed far-reaching extra-territorial prohibitions against other countries, the sanctions against Southern Rhodesia applied only to US citizens, residents or companies organized or having a principal place of business in the US or Rhodesia. US policy followed the British lead on sanctions by adhering to strict territorial principles of jurisdiction and by refusing to pierce the veil of corporate nationality of subsidiaries that were being used by their parents and affiliates to evade the sanctions regimes. Many critics attacked the policies of the

¹⁵⁴ See Reports in *Sunday Times*, London, 27 Aug. 1967, p. 9, cols.1–8; 3 Sept. 1967, 2, cols. 3–8. The multinational groups of Mobil, Caltex and Total provided petroleum and petroleum products in a similar fashion.

¹⁵⁵ See Reports of UN Security Council Committee 'Concerning the Question of Southern Rhodesia', 32 UN SCOR Spec. Supp. No. 2, Vol. II, 299 (1977), 33 UN SCOR Spec. Supp., No. 2, Vol. I, 294 (1978) *et seq.*

¹⁵⁶ The UK embargo had initially applied to UK citizens 'ordinarily resident in the United Kingdom', 'citizens of Southern Rhodesia', and 'corporations incorporated or constituted under the law of the United Kingdom or the law of Southern Rhodesia, wherever the contravention takes place'. See The Southern Rhodesia (Petroleum) Order 1965, art. 1(2) (17 Dec. 1965, *amended* 24 Dec. 1965); The Southern Rhodesia (Prohibited Exports and Imports) Order 1966 art. 1(4) (20 Jan. 1966); The Southern Rhodesia (Prohibited Trade and Dealings) Order 1966, art. 2(6), 4(2), 6(6) (20 Dec. 1966).

US and UK governments, asserting that the laws and regulations should have been given extra-territorial effect. Mobil and Shell responded by denying liability under either US or British law (or any other legal regime) because the sanctions were not technically extra-territorial in their coverage and did not authorise the piercing of the corporation's veil of nationality. Britain and the US failed to apply the sanctions extra-territorially because they lacked the political will to do so. It appears with hindsight that if the UK and US had been serious about imposing an effective sanctions regime against Southern Rhodesia, they would have adopted regulations that required parent companies, as controlling shareholders and overall managers, to direct their subsidiaries to obey the embargoes.¹⁵⁷ Moreover, there should have been some sort of regulatory duty of inquiry imposed on top-level management, so that the parent company could not say, as Shell and Mobil did, that it could do nothing about its subsidiaries' breach of the sanctions regime.¹⁵⁸

In addition, given that the sanctions against Rhodesia were based on a unanimous decision of the Security Council, it appears that public international law should have trumped private international law principles favouring deference to the law of the state where the subsidiaries were established. However conflicts between the public law obligation of implementing the Security Council resolution restricting trade with Rhodesia and principles of private company law and territorial jurisdiction were not resolved.

In the 1990s, international sanctions that were more targeted on financial transactions and strategic goods and parts were much more effective in achieving their stated objectives. In the early 1990s, the Security Council adopted Resolutions 748 and 883 that required UN members, *inter alia*, to prohibit the supply of aircraft-related services to Libya and to prohibit the supply of arms and related material, technical advice, and military advice to Libya.¹⁵⁹ Resolution 883 required member states to impose an economic

¹⁵⁷ In congressional testimony, officers of the Mobil parent stated that there had been no violation of US law either by Mobil Rhodesia or Mobil(South Africa) because Mobil Rhodesia was not prohibited under US or Rhodesian law from marketing inside Rhodesia products it purchased from the Rhodesian state marketing agency, GENTA; while Mobil (South Africa) was not strictly prohibited under US law from selling non-US origin goods to Rhodesia. See 'South Africa-US Policy and the Role of US Corporations', Hearings before Subcomm. on Africa of Senate Comm. on Foreign Relations, 94th Cong., 2nd, Sess., 357-377 (17 Sept. 1976).

¹⁵⁸ Mobil officers had claimed in their congressional testimony that it could uncover no information about its South African subsidiary's business dealings in Rhodesia because it was a criminal offence under South African law to transmit outside the country information which would prejudice the security interests of South Africa. In fact, Mobil's spokesman stated that 'there was nothing further which Mobil can do to resolve the matter, which involves matters of national policy required to be handled on a government-to-government basis'. *Ibid.*

¹⁵⁹ See 31 *ILM* 749 (1992).

embargo against Libya that required a complete freeze of Libyan assets and ban on transfers of financial resources.¹⁶⁰ Specifically, paragraph 5 of Security Council Resolution 883 required all UN members to 'prohibit any provision to Libya by their nationals or from their territory of the items listed in the annex to this resolution, as well as the provision of any types of equipment, supplies, and grants of licensing arrangements for the manufacture or maintenance of such items'.¹⁶¹

Most UN member states implemented these provisions faithfully and because the sanctions themselves were focused on airline parts for the Libyan aerospace industry and drilling equipment for Libya's oil and gas industry, they were easily monitored by the Security Council sanctions committee. For example, the US implemented the provisions into US law under the Iran/Libya Sanctions Act of 1996, although the US had already had a comprehensive set of regulations in place that prohibited trade and financial transactions with Libya or Libyan entities.¹⁶² Other countries, including the European Community and its member states, adopted strict controls that implemented the requirements of both resolutions. Specifically, the EU regulation and UK statutory instruments called for the establishment of a mandatory sanctions regime on EU nationals and any person present in EU states who 'violate UN Security Council Resolutions 748 and 883 by selling weapons, aviation equipment and oil equipment to Libya'. Unlike the Security Council resolutions imposing sanctions against Southern Rhodesia, the sanctions resolutions against Libya were effective because they were narrowly focused on strategic areas of the Libyan economy (oil, gas and airline parts) and that these categories of products were more easily monitored and verified than the broader list of prohibitions and restricted goods in the Southern Rhodesia sanctions. Moreover, there was a stronger political willingness to isolate Muammar Gaddafi's regime because it had been directly supplying terrorists groups with arms and money that allowed them to conduct a number of deadly attacks on the US and western Europe in the 1980s and 1990s.

Conclusion

The chapter has reviewed the major economic sanctions regimes and some of the main challenges of aligning the legal and regulatory techniques of

¹⁶⁰ SC Res. 883 (1993), para. 3.

¹⁶¹ UN SC. Res. 883. The annex listed five categories of goods but did not include services.

¹⁶² Indeed, the congressional committee report on the Iran/Libya Sanctions bill refers to 'a mandatory sanction framework for violations of the internationally agreed trade regime'. H.R. Rep. No. 104-523, pt. 2, at 15; 142 Cong. Rec. H6476 (daily ed. 18 June 1996; colloquy between Reps. Gilman and Gejdenson).

sanctions implementation and enforcement with their public policy objectives. Most of the academic and policymaking literature has criticised multilateral sanctions and unilateral sanctions programmes for failing to achieve their stated objectives while imposing substantial collateral damage on civilian populations and third country states. Moreover, they claim that most economic sanctions programmes are ineffective because they are too easily circumvented. This chapter suggests an alternative view, however, that holds that the economic sanctions regimes of the leading industrial states have become more effective in recent years in imposing costs on targeted states and individuals and bringing about intended policy changes in sanctions targets because the global economy has become more liberalised which has made it easier for states to extend their regulatory and economic controls beyond their territorial borders and states have moved away from comprehensive embargoes to more targeted sanctions whose results are easier to measure and which can be adjusted more effectively to achieve policy objectives. Moreover, advances in technology have facilitated the use of targeted sanctions that can more effectively reach extra-territorial conduct. Economic sanctions practice has therefore been transformed by the changing structure of the global economy and by the renewed emphasis of many states to adopt more targeted sanctions with specifically defined objectives and conditions for their application.

5

Economic Sanctions, Corporate Law and Control Liability

Introduction

The chapter's purpose is to analyse principles of control liability under the major common law systems and apply such principles to the use of economic sanctions. In doing so, the chapter examines the legal and regulatory concept of control liability as it applies to corporate entities and controlling investors. The chapter also examines how the enterprise liability doctrine can lead to the attribution of civil and criminal liability for regulatory and statutory breach to all members of the multi-national business enterprise based on their capacity to control certain aspects of the regulated entity. Under this doctrine, economic sanctions regulations can potentially apply to all affiliated and controlled members of the multi-national group through the mechanism of control or shared control, regardless of the nationality of particular entities within the group. The chapter suggests therefore that the concept of control liability provides a useful legal technique for states when implementing economic sanctions laws by imposing controls on corporate groups and other entities.

I Multi-national firms and economic sanctions

Most multi-national corporations based in Europe, Japan and the US are primarily organised as groups of corporate entities in hierarchical form with a parent corporation and numerous subsidiaries and branches collectively conducting the business of the group (Blumberg, 1993, 6–10). Multi-national corporate groups can also be organised in a more decentralised form in which decision-making authority is allocated horizontally across several subsidiaries or affiliates within the group structure. Nevertheless, the centralisation of decision-making and management structure at the parent company level has been the main trend in recent years regarding the governance of corporate groups. In the financial industry, multi-national financial groups often take the form of conglomerates that provide an array

of financial services through a host of subsidiary and affiliate companies (Canals, 1997, 37–42). The parent company usually exercises hierarchical control through its controlling shareholder interest in a number of financial subsidiaries. Alternatively, it may be structured horizontally with several affiliated companies exercising control – either individually or collectively – over the operations of each financial entity within the group.¹

Multi-national corporate groups based in the US generally operate through wholly owned subsidiaries, but an increasing number of US subsidiaries within such groups are partly owned by the parent company (James and Weidenbaum, 1993, 48). Similarly, hierarchical corporate structures are also dominant in European multi-national groups; but the pattern of wholly owned subsidiaries has not been as widely accepted as in the US (Andenas and Wooldridge, 2008). Although the structure of European multi-national groups is more complex than in the US, they bear some resemblance to those in the US because of their overall hierarchical structure (McCahery, 1993, 16–20). In Japan, the main governance structures of multi-national corporate groups have been in the form of the *zaibatsu* and *keiretsu*, and the *kigyoshodan*, all of which exhibit high levels of hierarchical control (Krasnow, 1993, 58; Scott, 1993). Regardless of whether the subsidiary is wholly owned or partly owned, however, members of the multi-national group operate under the control of the parent corporation (Blumberg, 1983, 33–35). Indeed, the concept of control constitutes the essential element for understanding how the activities of the group are co-ordinated to achieve the enterprise's business objectives.²

Multi-national groups and financial conglomerates pose a number of challenges for cross-border regulatory co-ordination (Benston, 1994, 127). In the area of economic sanctions, regulators and law enforcement authorities have found it difficult to coordinate their supervisory functions and to monitor the cross-border activities of business enterprises that may be attempting to evade or circumvent sanctions restrictions (Doxey, 1980, 118). Indeed, the often opaque and complex structures of many corporate groups require regulators across different jurisdictions to oversee their international activities and this is particularly true in respect of overseeing compliance with international and national sanctions regulations.

Several home-host issues arise regarding how corporate groups should be regulated with respect to sanctions implementation. First, should the

¹ Although it is generally accepted that the modern multi-national corporation does not exercise sole control over the other members of the corporate group, it retains a substantial amount of authority to direct the affairs of the multi-national enterprise (Blumberg, 1993, 328).

² Even in the situation where two corporate groups share control for the purpose of conducting a joint venture, such shared control will generally exist in an area of tangency between them (Blumberg, 1993).

corporate group be treated as a single entity and therefore subject to the regulation and supervision of the jurisdiction where its holding company is incorporated or registered? Second, should the conglomerate be treated as a decentralised structure and thus subject to the regulation and supervision of the jurisdiction where its entities are incorporated or registered? Or, third, should there be a more elaborate allocation of regulatory responsibilities between the regulators of the jurisdiction where the holding company is incorporated or registered and the regulators of jurisdictions where the institutions or entities of the conglomerate operate? Presently, there is no unifying approach among national regulators regarding how they apply economic sanctions controls to multi-national corporate groups and conglomerates. US regulators, for instance, attempt to extend economic sanctions controls to all members of a multi-national group so long as one of the controlling subsidiaries is based in the US or subject to control by a US entity or individual. The US regulatory regime relies on principles of control liability to pierce the veil of corporate nationality in order to extend sanctions liability to foreign shareholders who exercise control over a US entity. In contrast, UK regulation generally adheres to the formality of the corporate entity and does not attempt to pierce the veil of the company in order to impose sanctions on controlling shareholders unless they are UK nationals or UK-based. UK regulation generally respects the corporate veil and will not extend liability to foreign entities or persons outside the UK who control a UK entity or are subject to control by a UK entity.

These different legal techniques for the regulation of corporate groups are emblematic of the different approaches used by many states to apply economic sanctions measures to the operations of multi-national enterprises. The lack of effective co-ordination between national authorities, however, has resulted in disjointed and overlapping efforts to restrict the commercial and investment activities of corporate and business entities with targeted states and persons. Indeed, as with other areas of corporate regulation, existing legal frameworks – at both the international and national levels – have been criticised as not providing ‘a comfortable, tidy receptacle’ for resolving difficult regulatory issues for multi-national enterprises (Vagts, 1970, 740). This raises the important issue of whether for legal and regulatory, as contrasted with economic, purposes a multi-national enterprise is merely a collection of corporations organised under the laws of various states, or whether a multi-national enterprise composed of many corporate entities should be treated as having distinct legal characteristics. In this regard, the UK and US have taken different legal and regulatory approaches in applying the principle of control liability to corporate regulation and in particular to the application of economic sanctions. The following sections will examine the principle of control liability and how it is applied to business entities and corporate groups with respect to economic sanctions regulations.

II Control liability for corporations

Control liability for corporations derives from the principles of *respondeat superiore* and vicarious liability of corporations for the acts and omissions of their employees and agents while acting within the scope of their employment on the basis that companies, as principals, exercise control over their employees and agents.³ This type of liability for corporations has attracted criticism on the grounds that a corporation's governing instruments (charter, bylaws, director's resolutions etc.) rarely, if ever, authorise its agents to commit torts or other misdeeds.⁴ As a public policy matter, however, because corporations are better placed to monitor the behaviour of their agents and employees, they should incur the costs of any legal or regulatory breach, rather than third parties or the general public. Consequently, agency law creates vicarious liability for principals for the torts or statutory breaches committed by their agents (Fletcher, 1974, s. 4886).⁵

The US Supreme Court has ruled that criminal and civil liability may be attributed based on agency principles to corporations for the offences of their employees in breach of federal regulatory standards.⁶ The principal-agent theory and control liability doctrine have been instrumental for US regulators in imposing liability on business entities and individuals for breach of economic sanctions laws. For instance, the Anti-terrorism and Effective Death Penalty Act of 1996 authorises the Secretary of State to designate foreign terrorist organisations (FTOs) and certain entities and individuals who are subject to the control and domination of a FTO. The designation of a FTO can lead to other entities and individuals being designated as aliases of the FTO if the US government can provide some evidence to show that the alleged alias entities and individuals are so controlled and dominated by the FTO that they can be

³ *Dinco et al. v. Dylex*, 111 F.3d 964, 968 (1st Cir. 1997). *United States v. St. Michael's Credit Union*, 880 F.2d 570 (1st Cir. 1989). Vicarious liability has also arisen for principals based on torts committed by their agents (Fletcher, 1974, s. 4886).

⁴ English courts have never generally accepted the argument that a company could not be liable for an *ultra vires* tort (Pettet, 2005, p. 29; citing s. 35(1) of the Companies Act 1985).

⁵ When the principal is a corporation, the common law has typically held the corporation liable when its agents are actually authorised to make tortious representations, regardless of whether the agent's authority is express or implied (Mayson et al., 2002, 685–687). See also US Restatement Agency, §§7 & 8 (1958). In addition, a corporation's liability for an agent's misrepresentations may rest upon a theory of 'apparent authority' in which the agent's tortious action, while not actually authorised by the corporation, appears so to those adversely affected. *In re Atlantic Financial Management, Inc.*, 784 F.2d, at 31 (Steven Breyer writing for the majority). Therefore, a corporation which has placed an official in a position to invoke its authority (though improperly), it may incur liability for misrepresentations committed by that corporate official who is acting with 'apparent', but not 'actual', authority.

⁶ *Trans World Airlines, Inc. v. Thurston*, 469 U.S. 111, 127 n.20 (1985).

considered to be one and the same.⁷ The US government's use of agency theory to impose sanctions against entities and individuals who are shown to be controlled or dominated by FTOs has become an important tool of US economic sanctions policy.

Similarly, US courts have applied agency principles for determining liability for violations of the Bank Secrecy Act's reporting requirements so that corporations may be held criminally liable for offences committed by their employees for failing to report suspicious transactions at US financial institutions. Such attribution of criminal liability to the corporate entity is based on the doctrine of collective knowledge, which holds that the acts of a corporation are simply the acts of all of its employees operating within the scope of their employment. Similarly, the knowledge obtained by corporate employees acting within the scope of their employment is imputed to the corporation for purposes of establishing the *mens rea* of a criminal offence.⁸ Accordingly, when an employee knowingly undertakes an act which is a criminal offence, such knowledge is imputed to the corporation. Moreover, for crimes that require specific intent, courts have ruled that a corporation is deemed to have acted wilfully if one of its employees acted wilfully in committing an offence within the scope of its employment.⁹ For example, a bank may be held criminally liable for the wilful failure of its employees to file currency transaction reports.¹⁰

In *United States v. Bank of New England*, the bank was charged with wilfully violating currency reporting requirements because employees of one of its branch banks had deliberately failed to comply with reporting requirements.¹¹ The state was required to demonstrate proof of the employee's knowledge of the reporting requirement and their specific intent to commit

⁷ *National Council of Resistance of Iran v. Department of State*, 373 F.3d 152, 157 (DC Cir. 2004); (imposing liability on the alias entity if the FTO 'so dominates and controls' the alias entity that they can be considered one and the same).

⁸ *United States v. Bank of New England*, 821 F.2d 844 (1st Cir. 1987). The court observed that corporations compartmentalise knowledge, subdividing the elements of specific duties and operations into smaller components. The aggregate of those components constitutes the corporation's knowledge of a particular operation. *Ibid.*, at 846.

⁹ *United States v. Beusch*, 596 F.2d 871 (9th Cir. 1979); *St. Michaels*, 880 F.2d at 573.

¹⁰ The Currency Transaction Report Act (the 'Act') requires banks to file currency transaction reports within fifteen days of a customer currency transaction exceeding \$10,000. 31 U.S.C. §§5311–5322 (2006). The Act imposes felony criminal liability under 31 U.S.C. §5322 only when a financial institution 'wilfully' violates the CTR filing requirement by failing to file such reports 'as part of a pattern of illegal activity involving transactions of more than \$100,000 in a twelve month period.' 31 U.S.C. §5322(b).

¹¹ Criminal charges were brought against the bank under 31 U.S.C. §5313 for failure to report the transactions of a client who presented several cheques to a bank teller, each under \$10,000 but which in aggregate totaled more than \$10,000, and the

the statutory offence in order to impute such specific intent to the bank. The court held the bank liable based on the principle of 'collective knowledge'. The knowledge obtained by the branch tellers and their specific intent to violate the currency reporting act was thus attributed to the bank.¹² The general principle of control liability adopted in the case appears to support the attribution of criminal liability not only to the home office of a corporation, but also to any controlling entity, which could include a parent corporation within a corporate group or a controlling shareholder of a corporation. The principle of the case is that criminal liability flows where control goes. Although it is possible to empathise with the policy goal of imposing sanctions on the upper echelons of corporate authority on the assumption that they are best equipped to deter wrongdoing at all levels of the enterprise, it should also be noted that in the realm of large corporate enterprises the attribution of liability to the head or parent office may not result in improved compliance at the front line of operation, especially given some modern company structures that emphasise horizontal decision-making authority (Blumberg, 1983, 126–129).¹³

Under US economic sanctions, the Office of Foreign Assets Control (OFAC) regulations and the Bureau of Industry and Security's (BIS) export administration regulations, impose criminal liability for knowing or wilful breaches of the sanctions regulations.¹⁴ As discussed above, wilfulness entails a voluntary and intentional purpose to disobey the law that uses a subjective standard to measure actual knowledge. The actual knowledge standard is more difficult to prove than the objective standard of 'knowingly' committing an offence, which measures culpability by reference to a reasonable person standard in which the defendant's awareness of certain facts infers the requisite *mens rea* to be guilty of the offence. The OFAC and EAR regulations prohibit respectively

teller would then transfer a lump sum of cash for the full amount. *Bank of New England* 821 F.2d at 845.

¹² The bank defended against the charges by arguing that because no single employee had the requisite knowledge for a finding of specific intent to commit the offence, that specific intent could not be attributed to the bank. The court rejected this argument by observing that 'It is irrelevant whether employees administering one component of an operation know the specific activities of employees administering another aspect of the operation'. *Ibid.* at 846.

¹³ In determining corporate criminal liability, English law has not adopted the 'collective knowledge principle' of US law, but rather has treated 'the state of mind of senior officers of the company as being the state of mind of the company'. See *Leonard's Carrying Company Ltd v. Asiatic Petroleum Co. Ltd* [1915] AC 705. The UK Privy Council has held that in special circumstances midlevel managers might be regarded as the 'directing mind and will' or the persons whose intent should be attributed to the company. *Meridian v. Securities Commission* [1995] BCC 942.

¹⁴ 31 C.F.R. §515.701 (OFAC penalties); 15 CFR part 719 (BIS penalties) and 15 CFR 764.2 (penalties) and 764.3 (penalties).

any US person (including US-controlled foreign person) from ‘willfully’ violating or ‘conspiring’ to violate any provision of these regulations.¹⁵ The OFAC regulations contain a lower threshold standard of knowledge to impose civil liability and penalties on officers, directors and shareholders who ‘knowingly participates’ in any sanctions violations.¹⁶ In contrast, the EAR do not contain any requirements to demonstrate knowledge or intent and have been interpreted as imposing a strict liability standard with regard to the imposition of civil liability and penalties.¹⁷ Under each of these offences, civil and criminal liability may be imputed to the corporate or business entity on whose behalf the offending individual was acting. The attribution of civil and criminal liability based on the concept of control raises important issues as to whether such liability can be imputed extra-territorially to a non-US individual or entity who exercises control over the operation in question. Similarly, it also raises the issue of whether such liability arising from the violation abroad by a US-controlled foreign person can be attributed to a parent or other controlling entity in the US. These questions will be explored in Section IV.

III Enterprise liability in the corporate group

The doctrinal framework of control liability discussed above provides the theoretical basis for analysing how principles of enterprise liability may be applied to impute liability within the multi-national corporate group for statutory or regulatory breach. The law of corporate groups is important for understanding how economic sanctions can apply to the transnational business enterprise or multi-national corporate group. As discussed above, the multi-national enterprise or corporation generally consists of numerous subsidiaries, many of which are organised under the laws of different jurisdictions and linked by common managerial and financial control and often pursue integrated business objectives.

Modern enterprise principles

Most major US industries are regulated by federal statutes that specifically adopt enterprise principles of control liability as the basis for enforcing their

¹⁵ 15 USC s 501.701 (penalties; 2006). The provision imposes criminal penalties for wilful violations by a corporation of up to \$1 million per violation, and up to \$100,000 per violation if a natural person. The EAR imposes criminal penalties on both natural persons or corporations for wilful violations in an amount up to five times the value of the exports or re-exports sent to the targeted country or \$1 million, whichever is higher. 15 C.F.R. s 764.3(b)(2)(i).

¹⁶ *Ibid.*

¹⁷ *In re Petrom GmbH*, Docket No. 04-BIS-11 (6 June 2006), 70 FR 32743, pp. 29–30.

regulatory programmes (Blumberg, 1983, s.22).¹⁸ Some key industries where principles of control liability have been adopted include banking, securities, investment companies, energy and communications. Moreover, numerous federal statutes expressly employ enterprise principles to regulate designated business activities and practices that occur over different industry areas. These include major federal statutes regulating international trade, including export and import controls, foreign investment, foreign corrupt practices and economic sanctions and anti-boycott laws. They apply enterprise principles to expand the scope of application of the regulatory programme and to prevent evasion and frustration of the statutory objectives. Indeed, the principle of 'control' liability often serves as the statutory basis for enforcing the regulatory programme. The principle of control has proven most effective because it expands the area of application to include controlling persons and other companies in the corporate group which comprises the regulated corporate entity (Blumberg and Strauss, 1992, s.22). These statutes are implemented by their respective administrative regulations in which the concept of control plays a principal role in determining which parties are subject to the regulatory programme. Although the definition of control varies somewhat according to statute, it generally involves the ability to control the decision-making of the corporation.

Furthermore, it is important to note that when considering the various standards of control, the definition of control assumes a different meaning and significance depending on both the statute and the particular purpose or context for which the statute was enacted. For example, under some statutes, the mere possession of control may be sufficient to subject a party to regulatory obligations. This may lead to the imposition of statutory obligations on parties who share control. The context and purpose of other statutes may require as a condition for imposing liability that the party exercise some control. Moreover, liability for shared control may depend on the degree of involvement in the operations and decision-making of the controlled corporation by each of the parties sharing control. Such statutes in which standards of liability are specifically defined are known as statutes of specific application. Under most US federal commercial regulatory statutes, the legislature and administrative agencies have adopted enterprise principles of control liability, whereby the courts have been directed specifically to implement such standards as construed by the relevant agency or as prescribed in statute.¹⁹ The administrative agencies have an important

¹⁸ US courts will apply common law doctrines of control liability to a federal statutory regime if to do so would advance the goals of the particular federal statute. See *Petro-Tech, Inc. v. Western Co. of North America*, 824 F.2d 1349, 1356 (3rd Cir. 1987) (citing *American Soc'y of Mechanical Eng'rs v. Hydrolevel Corp.*, 456 U.S. 556, 570 (1982)).

¹⁹ By contrast, when the legislature and administrative agency make no reference to enterprise principles of liability in a particular statute, US courts have

role because they have discretionary authority to expand or reduce the scope of statutory coverage. Under these statutes, control plays a primary role in determining whether liability for statutory breach may be attributed to third parties who exercised control over a regulated party that breached certain standards of conduct. The effectiveness of a country's economic sanctions regime will depend in part on how policymakers utilise and courts interpret the doctrine of enterprise liability to impute liability for regulatory breach to affiliated and controlling entities within the multi-national corporate group.

English law of corporate groups

In contrast, the English law of corporate groups has provided more deference to the separate entity status of corporations and their limited liability within the corporate group. This can be attributed mainly to the importance of the *Salomon* principle that was adopted by the House of Lords in a late nineteenth-century case that recognised the limited liability of shareholders for creditor claims against the company (Prentice, 1996, 470–471).²⁰ Because of the *Salomon* principle, English law has been unwilling to lift the corporate veil and to develop a more sophisticated law on corporate groups.

Although the structure of corporate groups is widespread in the UK, English courts, unlike US courts, have been reluctant to develop a systematic law of corporate groups without legislative intervention (Prentice, 1992, 279). For instance, parent company liability for the acts of wholly or partly owned subsidiaries has been recognised by UK legislation in the narrow areas of taxation and the reporting of company accounts. Consequently, English courts have felt constrained in developing an overarching principle of enterprise liability because they are reluctant to intervene in matters that have received legislative attention, although on a far less comprehensive basis than in the US.

The policy rationale of shifting liability based on enterprise principles to the parent company or to a controlling affiliate presents a strong argument for departing from the strict application of the *Salomon* principle. The use of the corporate form and limited liability, however, to protect the company's owners from a claim in excess of their share capital is an accepted principle of English law.²¹ Prentice (1996, 280–281) notes that the policy of risk

refused to adopt enterprise principles except in the most extreme cases. See Blumberg and Strasser (1992, 78–80).

²⁰ *Salomon v. A Salomon & Co Ltd* (1897) (HL) AC 22.

²¹ *In re Baglan Hall Colliery Ltd.*, [1870] 5 LR-Ch. pp. 346–347 (court approves of owners' decision to change an unprofitable colliery into a limited liability company in order to avoid the risk of incurring personal liability).

shifting or risk minimisation has never been seriously challenged in English courts and so the principle of limited liability will continue to be observed under English law in the foreseeable future.

IV Control liability and economic sanctions

Despite the *Salomon* principle, the modern forces of economic and financial globalisation have necessitated that states enhance their legal and regulatory powers so that they can more effectively regulate control decisions wherever they may be made in the corporate group. US economic regulation now extends, under a number of statutory regimes, its regulatory power on an extra-territorial basis to regulate decision-making that directly affects US economic activity and commerce. It does so through the principle of control liability which can pierce the veil of corporate nationality to allow the long arm of US law to extend to the business affairs of non-US companies if they exercise sufficient ownership or control over US companies, or if they are owned or controlled by US companies or persons. Indeed, the concept of control is the principal legal mechanism through which the US government imposes its jurisdiction extra-territorially over non-US companies and business entities that operate outside US territorial jurisdiction but which are defined by US law as being subject to the control of US persons. Although such notions of control and shared control may prove to be negligible in an operational sense, the Office of Foreign Assets Control (OFAC) has defined US control of a foreign entity to occur when as little as 10 per cent of its shares or interests have been obtained by a US person (Hoffmann, 1998).²² Moreover, a non-US business entity would be considered subject to US control and thus to US economic sanctions regulations if a US person exercises, or has the capacity to exercise, any type of managerial authority (i.e., as a controlling officer or director) over the entity, regardless of the amount of US ownership interests. Such a broad definition of control has allowed the US government to extend the scope of its economic sanctions laws to a multitude of foreign business entities that are considered by US law to be US-controlled. The sweeping scope of US regulatory control has become more pronounced in recent years as US multi-national corporations expand their global operations and account for an increasing share of world output (Gilpin, 1987, 76–81). In particular, the liberalisation and deregulation of global financial markets have permitted US-controlled multi-national financial institutions to extend their influence and control over non-US

²² In May 1998, then OFAC General Counsel William Hoffman gave an example at a meeting of the American Bar Association in New York of how US economic sanctions could be imposed extra-territorially on a foreign entity if a US person owns or controls at least 10 per cent of the shares or interests in such entity, provided however there were no other non-US persons who owned or controlled an equivalent amount.

financial institutions in a manner that subjects them to US regulatory control (Smedresmann and Lowenfeld, 1989, 735–740).

Nationality principle and control liability

The nationality principle is essential for determining whether US economic sanctions can be imposed extra-territorially on third country persons. Regarding third country business entities, OFAC regulations consistently identify ownership or control of a business entity by a particular national of a target country as a sufficient basis for considering the entity to be a national of the same country.²³ Accordingly, to understand the concept of control, one must define some of the main terms utilised by the OFAC in imposing the blocking prohibitions: (1) ‘specially designated global terrorist’, or ‘Foreign Terrorist Organization’, (2) any ‘designated foreign country’, (3) any ‘national’ of a designated country, and (4) any ‘specially designated national’, including any person acting for or on behalf of a designated country or terrorist.²⁴ The OFAC regulations use these terms precisely to identify targeted states, international terrorists and any person acting for or on behalf of designated foreign states or terrorists. Legal entities that are owned or controlled by targeted states or specially designated nationals are sometimes known as ‘cloaks’ (Domke, 1943; Fitzgerald, 1999, 83).

It should be recalled that international law has traditionally treated as ‘nationals’ of a country its subjects and citizens, business entities organised under its laws, and business entities with a principal place of business in the country.²⁵ Customary international law has generally not relied on the principle of control as a criteria for determining a legal entity’s nationality. This should be compared with the OFAC practice of defining a ‘specially designated national’ to include business entities owned or controlled,

²³ See §§515.303(c) & 500.302(a)(2)(business entity as ‘national’; controlled by, or substantial part of entity’s securities owned or controlled by). Under English law, the domicile and residence of a corporation is determined by its place of incorporation. In *Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd.*, however, the House of Lords held by a majority that a UK-incorporated company was capable of acquiring enemy character because its controlling shareholders were German residents. [1916] 2 AC 307. Lord Parker stated that a company could assume enemy character ‘if its agents or the persons in de facto control of its affairs, whether authorised or not, are resident in an enemy country, or, wherever resident, are adhering to the enemy or taking instructions from or acting under the control of enemies.’ *Ibid* at 327–331.

²⁴ *Ibid.*, §515.306 (specially designated national defined to include persons so designated by the Secretary, persons acting for or on behalf of the government or other authority of a designated foreign country, or a juridical person owned or controlled by any of the above).

²⁵ A business entity includes partnerships, corporations, associations and any ‘other organization’.³¹ C.F.R. §515.302(a)(2).

directly or indirectly, by the government or authorities of a target country 'or by any specially designated national'.²⁶

The broad meaning of the term 'national' in the OFAC regulations has been an intentional policy tool of the US government that addresses the World War II experience with corporate cloaks, which had operated for targeted countries in neutral third country states. The legal technique used to address the threat of 'cloaks' operating in third countries was the concept of vicarious prohibition, which relied on the concept of the 'specially designated national', which included, *inter alia*, any person 'acting for or on behalf of' a target country (Malloy, 2001, 440–444).²⁷

The concern with effective implementation has led to an expanded definition of 'nationality' in order to achieve a wide-ranging prohibition on trade against state and non-state targets. As a result, the definition of nationality extends beyond the traditional definition in international law to include any person acting or purporting to act for or on behalf of any national of the target country,²⁸ and 'any other person determined by the Secretary of the Treasury to be 'or ... deemed to be' within the definition'. A person therefore subject to US jurisdiction is subject to civil and criminal sanctions for dealing with a person who acts, or purports to act, directly or indirectly, 'for the benefit or on behalf of any national' of a targeted country.²⁹ For instance, if OFAC determines that a US person or US-controlled foreign person is acting as a cloak for a targeted state or terrorist group, then it can impose a type of vicarious liability under the sanctions regulations by merely acting for or on behalf of the targeted country or terrorist organisation.

By blacklisting third country persons who are defined as acting on behalf of targeted states, their nationals, or designated terrorists, the US government brings indirect dealings with third country intermediaries within the scope of US trade controls and economic embargoes. As a result, third country persons who are otherwise beyond the reach of US territorial jurisdiction are subject to extra-territorial controls. This has the effect of influencing the behaviour of those third country persons who are beyond the direct reach of US sanctions by requiring those whom the government can reach to cease further dealings with the blacklisted party. This, in turn, puts pressure on third country persons to terminate their economic relationship with tar-

²⁶ C.F.R. §515.306(a)(3) In contrast, an 'unblocked national', is a person so licensed and regarded as a person within the United States and not as a national of a designated foreign country.

²⁷ 31 C.F.R. §500.306(a)(2). The OFAC publishes a complete list of specially designated nationals and other blocked persons under the OFAC and Export Administration Regulations (EAR) of the Department of Commerce. See Office of Foreign Assets Control, Specially Designated Nationals and Blocked Persons, 15 April 2008.

²⁸ 31 C.F.R. §§500.302(a)(4).

²⁹ 31 C.F.R. §500.302(a)(3)(including 'any person to the extent that such person is, or has been, since the 'effective date' acting or purporting to act directly or indirectly for the benefit or on behalf of any national of a foreign country).

geted states by forcing them to decide between having access to US markets, technology and products and maintaining their economic relationship with a targeted country, such as Cuba, Iran, North Korea and the Sudan, or a specially designated global terrorist organisation, such as Hamas or Islamic Jihad. Accordingly, a US person who enters a transaction with a blacklisted entity or individual in a third country is treated the same as a person entering the transaction with the targeted state or terrorist organisation.³⁰ Consequently, such commercial dealings with a third country specially designated terrorist or national can result in criminal and civil liability for a US person, even though the transaction was lawful under the laws of the country where the actions actually occurred.

US persons, including anyone located in the United States or amenable to its personal jurisdiction, rarely are specified as specially designated nationals (SDNs) because they are already obligated to abide by US embargo laws and may be directly punished for any violation. In some circumstances, however, the names of certain US persons or entities will appear on the SDN list as part of a broader enforcement action by the US government to impose criminal penalties and civil fines against US persons who violate economic embargoes. This may occur where the US person who is added to the list is controlled by or associated with the targeted country or entity, and thus becomes a means for US authorities to enforce economic sanctions by closing down the particular business or freezing all assets associated with that person. This occurred in *Islamic American Relief Agency v. Gonzales*, when OFAC designated a US-incorporated non-profit enterprise as a specially designated global terrorist (SDGT) because it had common origins with and a similar name to a Sudanese relief organization which had been designated by US authorities as a FTO.³¹ OFAC admitted that its designation of the US entity was not based on any allegation that the US entity had engaged in terrorist acts or had supported terrorism abroad, nor that it was owned or controlled by a FTO, but rather because it shared a common 'genesis and history' and a similar name with the Sudanese FTO, and that the US entity's articles of incorporation had listed the Sudanese FTO as one of its beneficiaries.

The court upheld OFAC's SDGT designation of the US entity on the grounds that there was adequate evidence to suggest that the US entity was a mere 'branch' of the Sudanese FTO, and that it was not necessary to show that the US entity was controlled or dominated by the Sudanese FTO. Moreover, the court held that its standard of judicial review of an executive agency SDGT designation should be 'extremely deferential' and should only be overruled if the decision was not based on substantial evidence and was

³⁰ See 31 C.F.R. §515.302 (1997; definition of national).

³¹ *Islamic American Relief Agency (IARA) v. Gonzales*, 477 F.3d 728, 732 (DC Cir. 2006); (holding that OFAC had demonstrated adequate evidence to support its designation of a US-based charity as a specially designated global terrorist because it was related and connected to a foreign terrorist organisation).

arbitrary and capricious.³² The court also reasoned that its review of a SDGT designation involves ‘sensitive issues of national security and foreign policy’ and therefore should be accorded a high degree of judicial deference.³³ In addition, OFAC has also designated US companies and persons as SDNs for trading with and being subject to the control of US-targeted states. For instance, in 1982 OFAC designated two Florida-based companies, KOL Investments, Inc. and American Air Ways Charters, Inc., because they had been deemed by OFAC to be subject to the control of the Cuban government, purportedly because they had engaged in unlicensed transactions with Cuban entities. The effect of their blacklisting was that US authorities shutdown their US operations.³⁴ Essentially, OFAC designations can involve both foreign and domestic entities, organisations and individuals if there is evidence to suggest that they are dominated or controlled by targeted states, persons or organisations or affiliated by status or association with such targets.

The concept of control and extra-territoriality

The term ‘control’ is not defined in the regulations, and has not been the subject of formal codified interpretation. A provision within the definition of ‘national’ though provides a formulation or description of ‘control’ which states in relevant part:

[a]ny partnership, association, corporation, or other organization, ... which on or since such effective date was or has been controlled by, or a substantial part of the stock, shares, bonds, debentures, notes, drafts, or other securities or obligations of which, was or has been owned or controlled by, directly or indirectly, a foreign country and/or one or more nationals thereof as defined in this section.³⁵

The language of this provision has been analysed by Malloy (2001, 444–446), who concludes that the open-ended definition of control can only be determined on a case-by-case basis, rather than by any prescriptive definition that would apply uniformly to similar business entities or factual scenarios.

OFAC will typically find control where a US person serves as a managing officer or director of a foreign business entity, or exercises a controlling

³² *Islamic American Relief Agency (IARA) v. Gonzales*, 477 F.3d at 734 (citing *Humanitarian Law Project v. Reno*, 205 F.3rd 1130, 1137 (9th Cir. 2000)); (observing that court ‘ow[ed] the executive branch even more latitude than in the domestic context’ and that the high degree of judicial deference to the decision to designate an entity as a FTO ‘is a necessary concomitant of the foreign affairs power’).

³³ *Islamic American Relief Agency (IARA) v. Gonzales*, 477 F.3d at 734.

³⁴ See 31 C.F.R. §515, ch. V app. B. See ‘Main Air Link Between U.S. and Cuba Shut Down’, *New York Times*, 17 April 1982.

³⁵ 31 C.F.R. §500.302(a)(2)(1998).

interest in a foreign company. In a small company, the minimum threshold would ordinarily be a majority of shares or any amount which would entitle the US investor to act unilaterally in appointing officers or directors, or in exercising managerial control of the company. In a larger, publicly held company, OFAC may recognise a controlling interest where the US person owns or controls as little as 10 per cent of the company so long as no other non-US person owns or controls an equal amount or more of the shares of the company. The issue of control then becomes crucial for determining whether a non-US business entity operating in a foreign country is subject to US jurisdiction. Under this definition, a company registered in France with a principal place of business (*siege social*) also in France would be considered a person subject to US jurisdiction under the OFAC regulations if its largest shareholder was a US company owning 10 per cent of the company's shares.³⁶

In addition, another crucial legal term that depicts the broad reach of US sanctions is the 'United States person', which presents the important issue of nationality. The OFAC regulations and Export Administration Act define 'United States person' broadly to include any 'person within the United States',³⁷ which has a broad effect to include any corporation, partnership or business entity organised under the laws of a foreign state but which is owned or controlled by US persons or individuals. This definition imposes extra-territorial jurisdiction on third country entities that are 'owned or controlled' by US persons in an almost identical manner to the OFAC definition of 'person subject to the jurisdiction of the United States'. Similarly, the export regulations define 'United States person' to include US citizens or residents, juridical entities organised in the US and their foreign branches, and 'any person in the United States'.³⁸ Although this definition appears to be less aggressively extra-territorial because it does not explicitly cover US-controlled foreign corporations and partnerships, its phrase 'any person in the United States' is strikingly similar to the above OFAC term 'person within the United States', which has a broad extra-territorial scope covering

³⁶ Ibid. See also Cuban Assets Control Regulations, 31 C.F.R. §515.329(a)–(d) (1998); (defining persons subject to US control and thus subject to extra-territorial jurisdiction under foreign assets controls).

³⁷ FACRs, 31 C.F.R. §500.330; EARs, 15 C.F.R. §744.6(c)(1)–(3); see also CACRs, 31 C.F.R. §515.330(a)–(d); 15 CFR s 329 (a)–(d). These provisions state that "person within the United States" includes: (1) any person, wheresoever located, who is a resident of the United States; (2) any person actually within the United States; (3) any corporation organized under the laws of the United States; or (4) any partnership, association, corporation or other organisation, wheresoever organised or doing business, which is owned or controlled by any persons specified in paragraphs (a)(1),(2), or (3). But see Libyan sanctions Regulations, 31 C.F.R. §550.330 (definition of person within US does not include US-controlled foreign persons).

³⁸ 15 C.F.R. §744.6(c)(1)–(3).

US-controlled foreign entities.³⁹ Taken together, these regulatory definitions of 'United States person' and 'Person within the United States' have the effect of ascribing US nationality to foreign corporations based on whether these foreign entities are owned or controlled by US citizens, residents or business entities. For instance, the OFAC regulations attribute the nationality of a corporation to its place of incorporation, principal place of management *or* to the nationality of its controlling shareholders.⁴⁰

The broad definition of 'US person' is intended to give US economic sanctions extra-territorial effect so as to prevent US-controlled multi-national groups from circumventing sanctions restrictions by transferring production, management and services to the foreign subsidiaries or affiliates of US-controlled multi-national enterprises. The regulations aim to exert US foreign policy control over US-controlled investment and trade, notwithstanding territorial boundaries. Moreover, the process of attributing the nationality of a foreign company to its controlling shareholder or owner results in a lifting of the veil of corporate nationality. Indeed, by adopting the nationality of its largest or controlling shareholder as a determining factor in corporate nationality, the regulation is a significant departure from customary international law's traditional reliance on the place of incorporation or principal place of management.⁴¹

Similarly, the OFAC regulations recognise the need to identify US and foreign companies as cloaks for targeted states or designated terrorists by piercing or lifting the veil of corporate nationality in cases where a corporation has at least 25 per cent of its shares owned or controlled by a targeted state, its nationals or a designated terrorist.⁴² In this way, if a company whose principal place of business and registration is in Britain but has 25 per cent of its shares owned or controlled by a designated Iranian company, it will be considered a specially designated Iranian national that is targeted directly by US sanctions.⁴³ Moreover, if the combined interests of two or more targeted countries or nationals thereof are sufficient in the aggregate to constitute control or ownership of 25 per cent or more of the stock, shares or other securities

³⁹ We are strongly encouraged to accept this definition because EARs expressly make reference to many OFAC terms and definitions to clarify ambiguities arising in the EAR regulations. See 15 C.F.R. §746.1(a)–(c).

⁴⁰ 31 C.F.R. §§500.302–303 (FACRs)(2006); 31 C.F.R., §515.330(a)(4)(2006)(CACRs).

⁴¹ *Barcelona Traction Power & Light, ICJ Reports, 1970, p. 4.* In contrast with the *Barcelona Traction* case, under US law, dual nationality for a corporation becomes a possibility where a company is incorporated in one state but has a plurality of shareholders who are nationals of another state.

⁴² See 31 C.F.R. §515.303(c).

⁴³ For instance, the branches and subsidiaries of Iranian banks operating in the UK would be subject to designations as SDNs by the US for their financial support of Iranian weapons proliferation. See Fact Sheet: Designation of Iranian Entities and Individuals for Proliferation Activities and Support for Terrorism (25 Oct. 2007) (designating Bank Melli, Bank Mellat and Bank Saderat).

or obligations of the company, OFAC will designate the company as a specially designated national and thereby subject it to sanctions.⁴⁴ Where the combined interests of two or more targeted states and their nationals exercise a controlling interest in the company, OFAC has discretion to use the nationality of *either* targeted state or entity to support sanctions under the Act.⁴⁵

Libyan Sanctions Regulations

When the Libyan Sanctions Regulations (LSRs) were in effect, they addressed a more specialised ‘control’ issue that arose in the context of non-US origin trade with Libya by foreign affiliates of US firms. Under these regulations, an OFAC specific licence was generally required by the foreign affiliate or subsidiary of a US corporation if the transaction undertaken by the foreign affiliate or subsidiary involved US persons or persons within the US who ‘engage in, participate in, or be involved in a licensed transaction with Libya or Libyan nationals’.⁴⁶ A specific licence was not required, however, if no US persons, or persons within US territory, were involved in the transaction with Libya or Libyan nationals. In essence, the licensing policy targeted day-to-day control by US persons of foreign affiliates as impermissible. In this context, however, the OFAC Libyan regulations provided guidance as to what activity would be considered control in this sense:

Such involvement includes, but is not limited to, assistance or participation by a US parent firm, or any officer or employee thereof, in the negotiation or performance of a transaction which is the subject of a license application ... [T]he affiliate must be generally independent, in the conduct of transactions of the type for which the license is being sought, in such matters as decision-making, risk-taking, negotiation, financing or arranging financing and performance.⁴⁷

This provision illustrated, and by no means was exclusive of, the situations that would have been deemed to represent day-to-day control of the foreign affiliate by persons within the United States, thereby prohibiting the issuance of a OFAC licence for trade by the foreign affiliate with Libya.

In addition, the United Nations Security Council addressed the issue of control liability when it adopted resolutions 748 and 883 against Libya that required all UN member states to implement national economic sanctions pro-

⁴⁴ 31 C.F.R. §500.303(c); CACRs, 31 C.F.R. §515.303(c). Where the country of registration differs from the nationality of the controlling shareholders, the company is treated as being a national of both. *Ibid.*

⁴⁵ 31 C.F.R. §500.303 (a)&(c).

⁴⁶ 31 C.F.R. §550.553(a).

⁴⁷ 15 C.F.R. §746(8). This provision and most of the US Libyan sanctions regulations were lifted by President Bush in 2004 after Libya agreed to cease its support for international terrorism and to turnover the two suspects who later stood trial in the Hague for the 1989 Lockerbie bombing.

hibiting most types of trade and investment with Libya and that mandated the termination of transactions with entities that are 'owned or controlled' by the Libyan Government or Libyan nationals. Since the UN relies on its member states to implement and enforce sanctions at the national level, definitions of ownership and control of a person or business entity varied from state to state. This caused considerable controversy amongst states over whether particular business entities were subject to Libyan control. For example, the Netherlands Antilles company Oilinvest (N.V.) was defined by OFAC to be a Libyan-controlled entity because it was wholly owned by the Libyan Oil Investments International Company.⁴⁸ Since Oilinvest (N.V.) was the parent company of Oilinvest (B.V.), its wholly owned Dutch subsidiary, the US also designated Oilinvest (B.V.) as a sanctioned person whose assets should be frozen and with whom no US person could trade.

After UN Security Council Resolution 883 was adopted on 11 November 1993, the Dutch Government was required to implement national sanctions regulations to block the property and assets of all companies, persons or entities which were owned or controlled by the Libyan Government or its nationals. A short time before Resolution 883 became effective, however, the Libyan Oil Investments International Company sold 51 percent of its interest in Oilinvest (N.V.) with the result that Oilinvest (N.V.) was no longer defined under Dutch law as a Libyan-controlled entity. This also meant that Oilinvest (B.V.) was no longer defined under Dutch law as a Libyan-controlled entity. Accordingly, the Dutch government refused to impose sanctions against either Oilinvest (N.V.) or Oilinvest (B.V.). The US government objected to the Dutch government's designation of the companies as not controlled by Libya and then unilaterally designated both companies as Libyan cloaks and subjected them to OFAC sanctions. This caused severe international transfer problems because the US continued to prohibit US-controlled foreign financial institutions from conducting any transactions involving Oilinvest (N.V.) or any of its subsidiaries.

Cuban embargo

The prohibitions on trade and financial transactions with Cuba are some of the strictest in the US sanctions regime.⁴⁹ Since the Cuban Democracy Act 1992,⁵⁰ the embargo has been tightened further to prohibit foreign firms

⁴⁸ See Office of Foreign Assets Control, Specially Designated Nationals and Blocked Persons, partial list(A-R) (Dec. 1998). Oilinvest International (N.V.) was listed as a 'Foreign Petroleum Investment Corporation', a.k.a. Libyan Oil Investments International Company. The Dutch subsidiary was known as Oilinvest (B.V.) a.k.a. Oilinvest Holland BV.

⁴⁹ CACRs, 31 C.F.R. §§515.201, 515.204 & 515.533.

⁵⁰ Pub. L. 102-484, 106 Stat. 2575 (23 Oct. 1992), *codified as* 22 U.S.C. §6001(1998). Today, Title I of the Helms-Burton (see Chapter 7) incorporates the Cuban Democracy Act. See Pub. L. 104-114, 110 Stat. 785.

that are owned or controlled by US persons from entering into any trade or financial transactions with Cuba, regardless of the strategic importance of the goods traded.⁵¹ Specifically, section 1706(a) of the Act prohibits third country companies and other businesses entities that are owned or controlled by US persons from engaging in any transactions with Cuba or Cuban nationals to the same extent as US persons are prohibited from engaging in such transactions.⁵² The provisions imposing restrictions on third country companies that are owned or controlled by US persons provide a clear application of enterprise liability principles in the Cuban trade embargo legislation.

The Act has been viewed as effective because of its use of enterprise principles to prohibit trade with Cuba by restricting non-US persons in situations where the US can exercise power over those foreign firms by means of its authority over those in the United States who own or control them. More bluntly, the Act authorises the use of the most tenuous type of control liability to limit or prohibit foreign business activity with Cuba by coercing US nationals who can exercise control over that activity.

Other US economic sanctions statutes (e.g., TWEA, IEEPA and EAA), however, provide no definition of control or controlling interest and do not expressly adopt enterprise principles. But US courts have interpreted the TWEA and IEEPA as delegating authority to the OFAC to make determinations of control on a case-by-case basis.⁵³ The Department also relies on the OFAC determinations of control in certain sanctions programmes.⁵⁴ Moreover, the OFAC has applied enterprise liability principles to define persons subject to US jurisdiction

⁵¹ In 1998, the US government loosened the embargo slightly by allowing certain agricultural implements, food and medicine to be sold through the US government to the Cuban government to alleviate food and health problems. See 'U.S. Backs Off Sanctions, Seeing Poor Effect Abroad', *New York Times*, 30 July 1998, A6.

⁵² §§1706–1712, 106 Stat. 2315, 2578–2581 (1992)(H.R. 5006). The Democracy Act eliminated the licensing criteria that had been used by OFAC since 1975 to issue specific licences to US-controlled third country persons to trade with Cuba so long as no US national participated in the transaction and that trade through the third country entity was not conducted for the purpose of circumventing the trade embargo. Before they were repealed in 1992, the licensing criteria were set out in 31 C.F.R. §515.559.

⁵³ *Kaufman v. Societe Internationale Pour Participations Industrielles et Commerciales, S.A.*, 343 U.S. 156 (1952); *Richardson v. Simon*, 560 F.2d 500 (2nd Cir. 1977); *Ferrara v. United States*, 424 F.Supp. 888 (S.D. Fla. 1976). The lack of a definition appears to be an intentional policy allowing US enforcement authorities to maintain maximum flexibility to define control on a case-by-case basis.

⁵⁴ Because the EAA did not grant authority to the Commerce Department to regulate non-US-origin exports by third country persons subject to US jurisdiction, the relevant definitions of 'control', 'person subject to jurisdiction', and 'United States person' relied on to enforce EAR are provided by the OFAC. See 50 U.S.C. app. §2403(b) (2006).

as a 'corporation, partnership, or association, wherever organized or doing business, that is owned or controlled by [US] persons'.⁵⁵

The concept of control liability based on enterprise principles is the principal legal basis relied on by the US government for adopting and enforcing economic sanctions against business enterprises. The extra-territorial application of US economic sanctions to the cross-border operations of multi-national corporate groups creates a significant level of legal and operational risk in the global operations of both US and non-US firms. The regulatory technique of using control liability to pierce the nationality of the corporate entity within the group structure in order to attribute liability to controlling investors, such as holding companies and affiliate companies, can potentially close a number of legal and regulatory gaps in the international enforcement of economic sanctions. Combined with the enterprise liability principle, control liability has provided an important legal basis for the extra-territorial application of US economic sanctions to foreign corporations and business entities. This has caused tremendous legal and political conflict, however, between the US and other major third country states, especially in the European Union, which will be discussed in Chapter 8.

Conclusion

The chapter discussed the doctrinal origins of control liability in the common law and how its recent manifestation in the enterprise liability doctrine under US law provides a legal and regulatory model for how economic sanctions regulations can apply to those who own or control business enterprises and can potentially apply on a cross-border basis to those in breach of international and national sanctions. The concepts of control liability and third party liability for trading and investment in violation of US economic sanctions have become more developed in recent years as regulators and courts have expanded the scope of liability under economic sanctions laws. US economic sanctions regulators have interpreted the control liability principle combined with the enterprise liability doctrine as providing extra-territorial jurisdiction over the foreign operations of US-controlled corporate groups regarding their commercial and trading activities with US-targeted states and persons. This type of extra-territorial regulation creates legal and regulatory risks for business entities that operate in and are organised under the laws of third country states. Control liability is a regulatory technique that allows national authorities to extend their regulatory oversight to the foreign business activities of corporate groups and conglomerates that operate in states that are not the target of

⁵⁵ See Foreign Assets Control Regulations, 31 C.F.R. §500.329(a)–(d)(defining person subject to US jurisdiction).

US sanctions but which may be doing business with US-targeted states and persons.

The chapter analyses some of the legal and regulatory techniques of US law that can potentially provide states with a model sanctions law that applies to business entities and corporate groups and that utilises the enterprise liability doctrine and the concept of control liability to transcend the limitations of entity theory in corporation law in order to hold all members of the corporate enterprise liable in some way for the corporate entity's breach of sanctions laws. The US government has demonstrated how this can work in practice by defining control broadly in the OFAC regulations to prevent US-controlled multi-national entities from circumventing US sanctions by channelling trade with targeted states through third country entities and subsidiaries. In contrast, however, the UK has not utilised control liability to any significant extent for the enforcement of its economic sanctions laws, nor has it recognised the doctrine of enterprise liability for applying UK economic regulation to corporate groups. The principle of control liability and enterprise liability doctrine are useful legal techniques that could assist countries in implementing international sanctions requirements. However, regional and national implementation efforts should be co-ordinated and monitored by international bodies in order to reduce overlapping application and regulatory gaps.

6

Third Party Liability and Economic Sanctions

Introduction

Chapter 5 examined the doctrine of control liability in US corporate regulatory law and how it addresses the complexity of multi-national enterprises and their cross-border activities and the need to pierce the veil of corporate personality in order to make economic sanctions controls more effective against the owners and controllers of complex corporate groups. The coherent interpretation and application of domestic legal and regulatory principles are necessary to ensure consistent application and implementation of economic sanctions across jurisdictions. This chapter analyses principles of third party liability and how they apply to third party intermediaries and professionals who facilitate, assist or aid and abet commercial transactions with targeted states and specially designated entities. Indeed, an important feature of third party liability concerns its application not only to parties in actual or direct breach of the regulatory regime, but also to those who have facilitated, participated, assisted or aided and abetted such breaches. In particular, the Department of Treasury OFAC regulations impose various degrees of civil and criminal liability on third party financial institutions and professionals which serve as intermediaries or accessories in facilitating or assisting transactions in violation of US economic sanctions.¹ Similarly, the Bureau of Industry and Security Export Administration Regulations (EARs) impose civil and criminal liability on those who facilitate or assist others in direct breach of US economic sanctions.² The UK economic sanctions regime creates a similar form of third party liability. UK financial sanctions and export control regimes are now playing a greater role in UK economic sanctions policy because of the UK's

¹ See 31 C.F.R. §500.100 *et seq.* (2006).

² See 15 C.F.R. §764.1–9 *et seq.* (2006; prohibiting aiding, abetting, assisting or facilitating violations thereof).

increased reliance on sanctions pursuant to European Union and UN Security Council sanctions programmes.

The chapter examines the third party liability principles that apply under the US and UK economic sanctions regimes and related liability principles under international law. The US and UK provide two of the most important economic sanctions regimes and have become increasingly effective in deterring professional advisers and financial intermediaries from performing transactions that facilitate and assist the contravention of economic sanctions obligations. By imposing liability against professionals and intermediaries, the regulations can potentially deter many sophisticated and complex international transactions involving targeted states and persons. These intermediaries and professional advisers – bankers, solicitors, and accountants – are uniquely positioned to perform complex transactions, and their services are required to enable targeted states and persons to have access to the formal financial system and to utilise commercial services in international trade. They typically operate on a transnational basis and are linked in many ways to the US and UK commercial and financial systems. As a result, they are likely to adopt risk management practices to comply with US and UK economic sanctions. The chapter will also discuss the doctrine of foreign illegality and how it applies to the overseas operations of banks and other firms that might be exposed to liability in a foreign jurisdiction for recognising the extra-territorial application of economic sanctions.

I Facilitative, participatory and accomplice liability

Before examining the third party liability principles under UK and US law, it should be noted that international law has recognised third party liability principles for individuals who aid and abet or assist in the violation of international law.³ National courts have consistently relied on criminal law norms to establish the content of customary international law in prohibiting genocide and war crimes.⁴ Indeed, the war crimes tribunals following World War II recognised as part of customary international law aiding and abetting liability as a mode of liability.⁵ Later, the Rome Statute of the International Criminal Court, and the statutes creating the International Criminal Tribunal for the Former Yugoslavia and the International Criminal

³ *Flores v. S. Peru Copper Corp.*, 414 F. 3d 233, 248 (2nd Cir. 2003).

⁴ *Kadic v. Karadzic*, 70 F.3d 232, 241–242 (2nd Cir. 1995).

⁵ G.A. Res. 96 (I), at 188–189, U.N. Doc. A/64 (11 Dec. 1946), the London Charter, Agreement for the Prosecution of the Major War Criminals of the European Axis (8 Aug. 1945). Article 6 provided that '[l]eaders, organizers, [and] instigators' and also 'accomplices participating in the formulation or execution of a common plan or conspiracy to commit' any of the crimes triable by the Tribunal.

Tribunal for Rwanda recognised that the concept of criminal aiding and abetting liability is ‘well-established’ in international law.⁶ Moreover, international law does not maintain a strict separation between criminal and civil law, as the courts of many countries permit the combination of civil and criminal proceedings when, for example, those injured by criminal activity are also allowed to recover damages in the criminal proceeding or in a separate civil proceeding.⁷ International law therefore recognises third party civil and criminal liability for violations of international law, including the mandatory provisions of international sanctions resolutions adopted by the UN Security Council.

Third party facilitative liability (or participative liability) is also a general principle of both tort and criminal law in most common law jurisdictions and in many civil law jurisdictions.⁸ It generally occurs when one personally participates in accordance with an agreement with another to cause a particular harm to a third person.⁹ This liability only arises when someone else has infringed the rights of another person, and thus such a breach by another person must be established so that both persons are ‘knowingly concerned’ in the contravention (Lomnicka, 2000). Some scholars regard this liability as ‘accessory’ to the extent that there is a primary wrongdoer (the person actually in breach) and another person (someone knowingly concerned in that breach) who is also liable.¹⁰ Such accessory and participatory liability exists generally in criminal law and to a lesser extent in civil law.¹¹ The American Restatement of Torts has adopted similar principles of facilitative liability by stating that the facilitator is responsible for the result of the united effort if his act, considered by itself, results in a breach of duty and is a substantial factor in causing the result, irrespective of his knowledge that his act or the act of the other is tortious (ALI Torts, s. 876c). These generally accepted principles of

⁶ See *Prosecutor v. Furundzija*, Case No. IT-95–17/1, Trial Chamber Judgment, para. 155 (10 Dec. 1998). See also *Prosecutor v. Akayesu*, Case No., ICTR-96–4-T, Trial Chamber Judgment, para 526 (2 Sept. 1998); (citing principle VII that states that ‘participation by complicity in the most serious violations of international humanitarian law was considered a crime as early as Nuremberg’).

⁷ *Sosa v. Alvarez-Machain* 542 U.S. 692, 762–763 (2004).

⁸ Facilitative/participative liability in the criminal context has been recognised as the accessory principle of criminal law. See *R v. Powell* [1997] 4 All ER 545, p. 549(j) (HL)(per Steyn, L.J.).

⁹ Facilitative or participative liability at criminal law generally is referred to as accessory liability. See Smith (1991).

¹⁰ Although accessory liability is a familiar term in criminal law, it is also used – albeit more controversially – in civil law. See *Allen v. Flood* [1898] AC 1, 172 (per Davey, L.J.); (a procurer of a breach of contract may be held as a accessory). See discussion in Sales (1990). Such secondary liability, however, is denied by Gardner (1996, 73).

¹¹ Accessory liability may also lead to ‘inchoate’ criminal liability; space limitations prevent its discussion.

participatory liability will be considered below because they provide the theoretical basis for considering how principles of facilitative liability and other forms of third party liability apply under economic sanctions laws and regulations.

Participatory civil liability

Although the House of Lords in *Credit Lyonnais Nederland N.V. v. ECGD*¹² declined expressly to extend general principles of criminal accessory liability into tort law, there are discrete cases where such participatory civil liability does arise.¹³ For instance, there is the joint tortfeasor principle whereby persons are liable for the commission of a tort in furtherance of a 'common design'.¹⁴ Moreover, the tort of conspiracy to injure by unlawful means may also impose liability on one who agrees to participate in activity which is itself a civil wrong.¹⁵ Similarly, procuring breaches of certain duties or rights that are contractual,¹⁶ statutory,¹⁷ and equitable obligations may give rise to a type of facilitative or participative liability.¹⁸ Such liability could arise where the third party's involvement was before or at the time of, or covers activity occurring after, the transgression (Lomnicka, 2000).

These categories of common law participative liability require a high degree of involvement. For example, liability would be imposed on the procurer for taking the initiative in inciting or procuring the transgression. Liability would also result for the joint tortfeasor or conspirator who jointly agrees with the transgressor to undertake the activity; and liability would also arise for someone who responded to the initiative of the transgressor by

¹² [1998] 1 Lloyd's Rep. 19 (CA), [1999] 1 All ER 929 (HL)[hereinafter ECGD].

¹³ Some eminent scholars have argued that the principles of criminal accessory liability and criminal aiding and abetting should be recognised in tort law as civil participative liability. See Atiyah (1967).

¹⁴ *CBS Songs v. Amstrad* [1998] AC 1013 (breach of copyright case citing as primary authority *The Koursk* (1924) 18 Ll. L Rep. 153 [1924] 140). English authorities are split over whether the procurer of a tort falls under a distinct head of liability or is in the joint tortfeasor category. The latter view was recognised in *Amstrad Consumer Electronic Plc v. British Phonographic Industry Ltd* [1986] FSR 159 (per Slade, LJ) (cf. Gildewell, LJ), and *ECGD* (per Hobhouse, LJ); the former view was held by Lord Woolf in *ECGD*, citing Lord Templeman in *CBS Songs Ltd*.

¹⁵ *Lonrho plc v. Fayed* [1992] 1 AC 448 (HL). The conspirator may also be a joint tortfeasor, but the precise relationship between the two heads of liability is unsettled.

¹⁶ *Lumley v. Gye* (1853) 2 E & B 216.

¹⁷ See per curiam decision of the English Court of Appeal in *Meade v. Haringey London Borough* [1979] 1 WLR 637 (CA).

¹⁸ *Prudential Assurance Co. Ltd. v. Lorenz* (1971) 11 KIR 78, cited in *Associated British Ports v. TGWU* [1989] 1 WLR 939.

giving encouragement and assistance (Lomnicka, 2000, 2).¹⁹ Participative tort liability, however, would likely not arise in the situation where the third party merely gave such assistance as was requested by the transgressor, or by simply looking on and doing nothing to stop the transgression, as some type of participation to show a common design is required. In the *ECGD* case ‘mere assistance’ was held not sufficient to impose civil accessory liability.²⁰

Although the state of mind for these torts varies, the high degree of involvement implies knowledge of the relevant transgression or the facts giving rise thereof. The important issue becomes what degree of knowledge and involvement are required to identify participative liability. English, Canadian and New Zealand courts have adopted the five categories of knowledge set forth by Gibson, J in the *Baden* case²¹ to identify participative liability for knowing receipt and for the tort of misfeasance,²² although this framework was rejected in the context of assisting in a breach of fiduciary duty by Lord Nicholls in *Royal Brunei Airlines Sdn Bhd. v. Tan*.²³ In *Tan* Lord Nicholls rejected the concept ‘knowingly’ and the *Baden* categories as poor criteria for determining participative liability in a breach of trust, and instead adopted ‘dishonesty’ or ‘lack of probity’, both of which contain subjective and objective elements, meaning not acting as an honest person would have acted in light of what was actually known. Such a subjective test is dependent on the assister’s actual knowledge and personal motivations,

¹⁹ Professor Lomnicka provides an analytical framework to determine participatory liability for regulatory breach; she adopts the concept of the ‘knowingly concerned person’ as the threshold for imposing participative liability; she also applies this concept to assess facilitative liability for tortious conduct at common law. Her framework uses the five categories of knowledge that were applied by Peter Gibson, J in *Baden v. Societe Generale pour Favoriser le Development due Commerce et L’ Industrie en France SA* to determine liability for knowing assistance in a breach of trust (1992) [1993] 1 WLR 509, 575H-576A.

²⁰ *ECGD*, pp. 23–25.

²¹ In *Baden*, Gibson, J. used five categories of knowledge for determining participative liability: (1) actual knowledge; (2) wilfully shutting one’s eyes to the obvious; (3) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (4) knowledge of circumstances which would indicate the facts to an honest and reasonable man; (5) knowledge of circumstances which would put an honest and reasonable man on inquiry. *Baden*, p. 576A. In *Baden*, the attempt to impose liability on the third party bank failed, but the categories of knowledge adopted by the court are useful for assessing liability in other cases.’

²² (*Equiticorp Industries Group, Ltd. v. The Crown* [1996] 3 NZLR 586; *Gold v. Primary Developments Ltd.* (1997)152 DLR (4th) 385; *Citadel General Assurance Co. v. Lloyds Bank Canada* (1997) 152 DLR (4th) 411. Moreover, for the tort of misfeasance, Clarke, J found the *Baden* formula of ‘considerable value’(despite the comments in *Tan*). See *Three Rivers DC v. Bank of England* [1996] 3 All ER 558, 581b.

²³ *Royal Brunei Airlines Sdn. Bhd. v Tan* [1995] 3 WLR 64.

as distinct from the objective standard of what a reasonable person would have known or appreciated.²⁴ The standard however contains an objective element insofar as it judges the assister by the generally accepted standards of 'honest conduct'.²⁵ Although Lord Nicholls regarded the more objective 'Baden scale of knowledge' as 'best forgotten', he confined his analysis to the context of assisting in a breach of fiduciary duty. As a result, the *Baden* categories of knowledge have survived as criteria for determining participative liability under some common law tort law theories and for regulatory breach. Therefore, in determining whether participative liability arises at common law the two components of such liability – state of mind and the degree of participation – should be considered together.

Participatory criminal liability

Participative criminal liability can ordinarily be assessed at common law through the traditional *mens rea/actus rea* dichotomy. In fact, the concept of the 'knowingly concerned' person provides a framework for analysing the state of mind and necessary factual ingredients for participative criminal liability (Lomnicka, 2000, 2–3). Regarding state of mind, the criminal law is typically concerned with subjective considerations (Smith, 1991, chs. 5–8).

Although it uses the terminology of 'intention' and 'recklessness', the defendant's knowledge is a significant element. For example, criminal intent and purpose may be inferred if the defendant knew that his acts would lead to a criminal outcome. The British criminal statutes interpret the adverb 'knowingly' as generally requiring a degree of subjective appreciation and as including 'willful blindness'.²⁶ Lomnicka argues that if 'knowingly' is to be interpreted by using the criminal law approach, it would appear to cover actual knowledge, wilfully shutting one's eyes to the obvious, and wilfully and recklessly failing to make such enquiries as an honest and reasonable person would make (Lomnicka, 2000, 9).²⁷ Moreover, criminal jurisprudence has analysed the various complex issues which arise in complicity and accessory liability (Smith, 1991, 139). The accessory's degree of

²⁴ *Ibid.*, pp. 106a&b. Moreover, Lord Nicholls stated that 'wilful blindness' may amount to 'dishonestly'. *Ibid.*, at 106b (stating 'Nor does an honest person... deliberately close his eyes and ears. or deliberately not ask questions').

²⁵ *Ibid.*, p. 107f. Lord Nicholls emphasised that '[h]onesty is not an optional scale, with higher or lower values according to the moral standards of each individual'. *Ibid.*, p. 106b.

²⁶ The criminal law concept of 'knowingly concerned' is found in the Fair Trading Act 1973 and the various Finance Acts.

²⁷ Lomnicka adopts the first three categories of the *Baden* scale. Participative liability in tort would also likely arise under the other two categories of the *Baden* scale: knowledge of circumstances which would have indicated the facts to an honest and reasonable man, and knowledge of circumstances which would put an honest and reasonable man on enquiry.

knowledge of the principal transgression will be the primary issue. There must be knowledge of the 'type' of activity;²⁸ it is not enough for the participant merely to contemplate some illegal venture; however, a high degree of specificity of knowledge is not required.²⁹ Moreover, an accessory would be liable who foresaw a real possibility that the principal might commit a greater offence than that agreed between them.³⁰

Although the criminal scope of third party facilitative/participative liability suggests a narrow view of the knowledge requirement of criminal intent, it permits a far broader range of activity or inactivity to satisfy the requirement of participation in the offence. Accessory liability has traditionally covered a wide range of participatory activity including aiding, abetting, counselling or procuring, or mere assistance.³¹ Even in some limited circumstances, no action whatsoever may be sufficient for liability (Smith, 1991, 145–159). These principles will be further discussed as they apply to US and UK economic sanctions laws and regulations.

Facilitative/participative liability under statute

Before we examine how principles of facilitative liability apply in the application of economic sanctions to third party facilitators or intermediaries, we must review and analyse how these principles have been applied under various statutory regimes. By way of illustration, this section summarises how US courts have applied principles of facilitative/participative liability to enforce US securities laws, and how such principles may be interpreted under British financial services and criminal law statutes.

The UK Financial Services and Markets Act 2000

Recent British financial services legislation has adopted the novel feature of authorising regulators to impose regulatory liability³² not only on those in actual breach of regulatory standards, but also on those who are 'knowingly concerned' in certain violations of these laws.³³ The 'knowingly concerned' standard has been accepted as a basis for determining whether participatory or accessory liability should be imposed against third parties who are involved in a breach of regulatory duty or obligation that is primarily

²⁸ See *DPP for Northern Ireland v. Maxwell* [1978] 1 WLR 1350 (HL).

²⁹ *R v. Powell* [1997] 4 All ER 545.

³⁰ *Ibid.*

³¹ *NCB v. Gamble* [1959] 1 QB 11 pp. 20–23 (per Devlin, L.J.); (a retail vendor of a gun was found guilty of assisting in the subsequent commission of a crime using the gun).

³² Liability for violating financial service regulations has been viewed by some scholars as *sui generis*, that is, neither strictly criminal nor civil, but 'regulatory' in that it is imposed 'at the behest of a regulator and is discretionary'. Lomnicka (2000, p. 4).

³³ See FSMA 2000, s 91(2); and Banking Act 1987, s. 48(1).

committed by another person.³⁴ Under the Financial Services Act 1986, the English Court of Appeal provided some guidance in *SIB v Pantell (No. 2)*³⁵ by holding that the term 'knowingly concerned' includes the 'directing mind and will' of a corporate transgression; but it also did not rule out imposing liability on other persons, such as the lawyers advising the transgressor.³⁶ Steyn, LJ attempted to define the criteria in *obiter* by first emphasising that consideration should be given, *inter alia*, to 'the contextual scene or setting' which would 'include the genesis of the statutory provision, countervailing considerations of policy and public interest and the common law and statutory framework'.³⁷ He also stated that proof of actual knowledge is essential but not enough.³⁸ To impose liability on third parties, they must somehow be involved in the actual contravention; mere passive knowledge is not enough. In a later case, *SIB v. Scandex Capital Management A/S*³⁹ he confirmed this view that actual involvement in the underlying transgression is an essential element. Most authorities accept Steyn's *obiter* remarks that 'actual knowledge' and 'actual involvement' are both necessary to show that a third party was 'knowingly concerned' and thus subject to facilitative/ participative liability for regulatory breach.

II UK financial sanctions and third party liability

As discussed in Chapter 4, the UK Treasury administers the application of UK financial sanctions and their implementation with financial institutions and firms. Until October 2007, however, the Treasury had delegated the responsibility to implement financial sanctions regulations to the Bank of England. The UK government adopts statutory instruments that implement all the United Nations and European Union sanctions requirements and regulations regarding the designation of persons and entities that

³⁴ The 'knowingly concerned' standard can be analysed in part by relying on the five categories of knowledge adopted by Gibson, J in the *Baden* case to determine whether someone 'knowingly' assisted in a breach of trust. *Baden* at 576A. See also Lomnicka (2000, pp. 2–3), and Snell's *Equity* (31st ed.) (2005, pp. 28–46).

³⁵ *SIB v. Pantell (No. 2)* [1993] 1 All ER 134, 138b (CA) (per Scott, LJ); on appeal from *SIB v. Pantell (No. 2)* [1991] 4 All ER 883 (per Brown-Wilkinson, VC); [1993] 1 All ER 134 (CA).

³⁶ In the only attempt to define the term, Lord Steyn, in *obiter*, considered it clear that 'proof of actual knowledge is essential but not enough' because actual involvement in the violation must be established. *Ibid.*

³⁷ *Ibid.*, at 146h.

³⁸ *Ibid.*, at 114f.

³⁹ [1998] 1 All ER 514. This case was a regulatory enforcement action under the Financial Services Act 1986 in which the defence of ignorance of the law was rejected on the basis that for liability to be imposed there was no need to know that a violation had occurred so long as the defendant knew, or had reason to know of, the facts which gave rise to the violation.

appear on UN Security Council and EU Council of Ministers sanctions lists. The UK legislation provides that it is a criminal offence to make funds or financial services available to designated persons whose identities are on lists maintained by the Financial Sanctions Unit of HM Treasury. Firms must report the details of funds that they have frozen under financial sanctions legislation and whether the firm has knowledge or a suspicion that the financial sanctions measures have been or are being breached. The firm must also report if the customer is a listed person, or a person acting on behalf of a listed person. A firm is guilty of a criminal offence if it fails to report a frozen account to the Financial Sanctions Unit. Unlike US legislation, there is no extra-territoriality requirement for firms in the UK, so they do not have a reporting requirement for transactions with designated persons if they occur in their overseas branches, offices or subsidiaries.

The obligation to report customers on the sanctions lists and not to engage in any direct or indirect commercial dealing with them is absolute and can lead to criminal and civil liability for firms and individuals who deal directly or indirectly with designated persons.⁴⁰ Liability can also arise for dealing with them indirectly through accountants and lawyers. Regarding criminal liability, it should be noted that all decisions to prosecute a firm or individuals for allegedly contravening the financial sanctions legislation and related regulations will be made based on principles set out in the Code for Crown Prosecutors. For instance, these provide that prosecution of a firm or individual for contravening the UK financial sanctions regime would only occur where the prosecutors have determined that to do so would be in the public interest. Part of this determination would involve assessing whether there was adequate evidence to meet the objective criminal liability standard for *mens rea* set forth in UK legislation that the third party had reason to suspect or believe that its transaction involved a designated person or firm and that it had later failed to act within a reasonable amount of time to report the transaction or designated person to the Bank of England.⁴¹ Also, a third party may not 'circumvent the prohibitions or to facilitate the commission of an offence relating to a prohibition'.⁴²

⁴⁰ HM Treasury's website states that a bank or financial intermediary is liable for a civil or criminal offence if it knows or suspects that a person who is, or has been at any time since the coming into force of the relevant legislation, a customer of the institution, or is a person with whom the institution has had dealings in the course of its business since that time (1) is a listed person, (2) is a person acting on behalf of a listed person, or (3) has committed an offence under the legislation, and it does not disclose the information on which the knowledge or suspicion is based to HM Treasury as soon as is reasonably practicable after that source to information comes to its attention. See *Financial Sanctions frequently asked questions* (Bank of England, 2007).

⁴¹ Statutory Instrument 2006/2657, art(s) 7 and 8.

⁴² SI, art. 10.

The objective criminal law standard adopted in the UK legislation poses considerable compliance challenges for firms as they must establish that they have acted reasonably in addressing the risk of conducting transactions with designated persons. To act reasonably, firms need to take certain *ex ante* and *ex post* measures that reduce the particular risks they face in breaching the obligations of the financial sanctions regime. Regarding *ex ante* measures, UK regulatory authorities generally follow a risk-based approach that must be reviewed and accepted by the UK Financial Services Authority and HM Treasury in determining whether firms have taken reasonable measures to mitigate the occurrence of transactions with designated persons. Firms are advised to allocate oversight resources to areas of their business that pose a higher likelihood of involvement with designated persons and entities. This allows firms to focus their preventive measures on specific lines of business that pose a significant risk and to monitor any relevant relationships with third parties, such as accountants, lawyers and financial intermediaries. For the firm to establish adequate internal safeguards, it will be necessary for it to monitor payment instructions to ensure that payments are not made to designated individuals or entities. In the situation where payments are made to regulated firms or financial intermediaries, it would be reasonable to suppose that these firms have regulatory safeguards and internal controls in place to prevent and detect transactions with target states. It would therefore not be necessary to have the same degree of oversight or monitoring of payments to regulated entities.

Regarding *ex post* reasonableness measures, when a firm matches a name and identity of one of its customers to an individual or entity's name on the Treasury's target list, it is required to freeze the funds it is holding on behalf of the designated person and to report this to HM Treasury's Financial Sanctions Unit and/or the Serious and Organised Crime Agency (SOCA). A firm is also required to make such reports where it has suspicions of terrorist financing. The firm has an obligation not to tip off the account holder because it might prejudice an investigation.⁴³ Once an internal or external suspicious activity report regarding possible financial sanctions breach has been made, it is a criminal offence for anyone to release information that may prejudice the investigation. This 'tipping off' offence also applies under the anti-money laundering and terrorist financing rules and it would apply in financial sanctions to situations where a firm has reported a transaction or blocked an account of a person deemed to be a person on the sanctions list or supporting a person on the sanctions list. Even where the person whose account has been blocked makes a reasonable request regarding the account which has been blocked, the bank or firm must not provide any information until it receives consent

⁴³ Proceeds of Crime Act 2002, ss. 333, 342.

from HM Treasury or SOCA. This means that a firm cannot tell a customer, unless given permission by the relevant authorities, that a transaction has been delayed because a report has been made to the authorities under the Proceeds of Crime Act 2002, and cannot tell the customer that the authorities are conducting an investigation.⁴⁴ These requirements only apply to a firm's UK operations, and not to their overseas branches, offices or subsidiaries.

The issue of whether there should be an objective or subjective standard of knowledge applied to determine whether a third party is liable as a 'knowingly concerned' person has been addressed in the academic literature. Lomnicka argues that the term 'knowingly' suggests a certain subjective appreciation, including wilful blindness, and that the objective standard of ordinary negligence is not required (2000, 19). This view takes account of the difficulty of imposing an objective standard of pure negligence liability on third party wrongdoers under the civil and criminal law. This problem becomes more obvious in civil law where participatory liability may only be imposed if sufficient nexus exists to establish a duty of care. Moreover, the negligence standard was rejected as inappropriate for determining participatory liability in the context of assistance in a breach of fiduciary duty. In contrast, however, UK criminal statutes have adopted the negligence standard for determining liability for negligent participation in crime.⁴⁵ Section 93A of the Criminal Justice Act 1993⁴⁶ adopts the objective knowledge standard for the third party facilitator for 'knowing or suspecting' that another party has engaged in criminal conduct; and Proceeds of Crime Act 2002 adopts the objective standard to determine involvement in the offence, that is, entering into or being concerned in an arrangement which concerns the retention or use of the proceeds of crime.⁴⁷ The third party intermediary

⁴⁴ *Squirrell Ltd. v. National Westminster Bank Plc.* (2005) EWHC 664 (Ch).

⁴⁵ Criminal Justice Act 1988, s. 93C(2)(supplemented by Criminal Justice Act 1993; objective standard of 'knowing or having reasonable grounds to suspect...'). The objective standard contrasts sharply with the subjective standard of the 1968 Theft Act, which dealt with the handling of stolen goods, where participatory liability would only be imposed where the party knows or believes the goods are stolen. Courts interpreted the Act as requiring actual knowledge or actual belief. The defendant was absolved of liability if she were unaware that the goods were stolen, even if the facts were obvious to the reasonable man. See Theft Act 1968, s. 19.

⁴⁶ The CJA 1993 created the identification of the five basic money laundering offences as criminal conduct and made certain amendments to the already existing drug trafficking and terrorist offences. The five basic money laundering offences are: (1) assisting another to retain the benefit or proceeds of criminal activity; (2) acquisition, possession or use of proceeds of criminal activity; (3) concealing or transferring the proceeds or criminal activity; (4) failure to disclose knowledge or suspicion of money laundering; and (5) tipping off.

⁴⁷ The Proceeds of Crime Act 2002, s. 328.

or professional has no obligation to report any suspicions unless it has involved itself by entering into or being concerned with an arrangement with the primary culprit, or has been engaged in acts related to the primary activity or benefited from the proceeds of organised crime. Section 93A is the basis for providing a negligence-based standard for knowing assistance or facilitative liability under UK criminal statutes.

Financial intermediaries are also required to perform some of these functions to minimise their liability exposure as third party facilitators under the 2007 Money Laundering Regulations (MLR).⁴⁸ These regulations require financial institutions to adopt internal control and detection procedures to monitor suspicious cash transactions and to have procedures to establish the identity of customers and to ascertain the source of their wealth.⁴⁹ In addition, the Financial Services and Markets Act 2000 imposes know-your-customer obligations on investment service firms when they give advice to, or exercise a discretion on behalf of, customers, thus requiring them to seek information about customers' circumstances and investment objectives in order to discharge properly their obligations. By complying with these obligations, the intermediary or professional may protect itself from facilitative liability that could arise from information which results in knowledge that would satisfy the 'knowingly concerned' liability standard. In contrast, failure to comply with these obligations, or failing to act on known facts, may result in facilitative liability based on a wilful blindness finding. In addition, although a firm reporting suspicions may well avoid an action for breach of confidence, it is not at all clear whether the legislation in question (in this case the Proceeds of Crime Act 2002) would protect against other civil or regulatory liability arising as a result of the disclosure.

Extra-territorial third party liability

The previous sections explored the doctrinal bases of facilitative and aider and abettor liability at common law and statute and under UK law. This section analyses the third party liability provisions of US economic sanctions regulations by examining their extra-territorial application to third country persons who facilitate, assist, aid or abet commercial transactions involving targeted states or designated persons. Before analysing these regulations, it is important to analyse the extent to which principles of third party liability have been applied extra-territorially by US courts under other federal criminal statutes. Based on this analysis and the theoretical

⁴⁸ S.I. 2007/2157.

⁴⁹ S.I. 1993 No. 1933 Reg. 5. See also, Drug Trafficking Act 1994, §52(imposing criminal liability for failing to report knowledge or suspicion of drug money laundering), and corresponding provisions §§50(3), 51(5)(requiring precautionary disclosure to relevant authorities).

framework of extra-territorial jurisdiction discussed in Chapter 3, it is suggested that the third party liability provisions of US sanctions regulations impose extra-territorial liability on non-US third party intermediaries and others who advise or facilitate transactions in violation of US economic sanctions.

The issue of whether third party intermediaries are liable for civil and criminal penalties under US economic sanctions for facilitating or assisting commercial transactions with US-targeted states and entities takes on an extra-territorial dimension when the third party facilitator is a third country national or corporate entity not ordinarily subject to US jurisdiction but whose acts of facilitation or assistance may subject it to civil and criminal penalties under US sanctions regulations. Although there is no constitutional bar to the extra-territorial application of US penal laws,⁵⁰ extra-territorial conduct can only be an offence against the United States if a US law purports to reach that conduct.⁵¹ While the third party liability provisions of US sanctions regulations contain no explicit language for their extra-territorial application to third country facilitators or aiders and abettors, it is my contention that these regulations may be enforced extra-territorially because of the rulings of the US Ninth Circuit Court of Appeals in *U.S. v. Felix-Gutierrez*⁵² and the Second Circuit Court of Appeals in *United States v. Heyman*.⁵³ In *Felix-Gutierrez*, the Court held that it was no violation of international law to give extra-territorial effect to a US statute imposing accessory after the fact criminal liability on a third party foreign national whose offence occurred entirely outside US territory if the underlying substantive offence was based on a statute that had been given extra-territorial effect.⁵⁴ The third party defendant was a Mexican national who was charged as an accessory after the fact for assisting a Mexican drug lord in eluding Mexican and US drug agents following the drug lord's participation in the kidnapping and murder of a US drug agent in Mexico. The third party defendant was charged, *inter alia*, under Title 18, section 3 of the United States Code, which provides that a person is an accessory after the fact if he 'receives, relieves, comforts or assists' someone he knows has committed an offence 'against the United States'.⁵⁵ The statute contains no reference in its text or legislative history to extra-territorial application. The court, however, ruled that the crime of accessory after the fact liability could result in extra-territorial jurisdiction to the same extent as the

⁵⁰ *Chua Han Mow v. United States*, 730 F.2d 1308, 1311 (9th Cir. 1984), *cert. den.*, 470 U.S. 1031 (1985).

⁵¹ *Felix-Gutierrez v. United States*, 940 F.2d 1200, 1204 (9th Cir. 1991)[hereinafter *Felix-Gutierrez*].

⁵² 940 F. 2d at 1204.

⁵³ *United States v. Heyman*, 794 F. 2d 788 (2nd Cir. 1986).

⁵⁴ *Felix-Gutierrez*, at 1205.

⁵⁵ 18 U.S.C. §3 (2006).

extra-territorial scope of the underlying offence.⁵⁶ The court concluded by stating:

Under such circumstances, neither the locality of the underlying offense nor of the related accessory after the fact offense is determinative of whether an offense has been committed against the United States; both extraterritorial offenses injure the government. Limiting the jurisdiction to the territorial bounds of the United States would greatly curtail the scope and usefulness of the accessory after the fact statute in cases in which extraterritorial crimes occur.⁵⁷

As a result, the accessory after the fact liability statute was given extra-territorial effect because it was based on acts that had occurred in Mexico which had violated the extra-territorial provisions of US drug enforcement statutes that proscribe the extra-territorial kidnapping and murder of US agents. Therefore, if the underlying substantive statute applies extra-territorially, the statute making it unlawful to assist another in avoiding apprehension, trial or punishment also applies extra-territorially when invoked in connection with an extra-territorial violation of the underlying statute.

Moreover, the court rejected the argument that extra-territorial jurisdiction as it was applied in this case was a violation of international law because it found that it was justified based on three jurisdictional principles of international law: (1) territorial, (2) protective and (3) passive personality. Under the first two of these principles, jurisdiction is based on the nature of the conduct or offence. US courts have defined the 'territorial' principle to include not only acts occurring within the United States, but also acts occurring outside US borders that have effects within the national territory.⁵⁸ Under the protective principle, jurisdiction is based on whether the national interest or national security is threatened or injured by the conduct in question. Similarly, the passive personality principle was also invoked by the court because it allows extra-territorial jurisdiction on the basis of nationality of the victim. The court found that the defendant's accessory after the fact crimes had had significant detrimental effect in the United States and had adversely affected the national interest.⁵⁹ Further, defendant hindered US efforts to prosecute an alleged murderer of a US government agent who was a US citizen. The court held that it did not have to give decisive effect to any one of these principles standing alone; rather, they could be applied cumulatively to justify extra-territorial application of the accessory after the fact statute. Indeed, the reasoning in *Felix-Gutierrez* would

⁵⁶ *Felix-Gutierrez*, 940 F. 2d at 1205.

⁵⁷ *Ibid.*

⁵⁸ See *United States v. Aluminum Co. of America*, 148 F.2d 416, 443 (2nd Cir. 1945).

⁵⁹ *Felix-Gutierrez*, 940 F. 2d at 1206.

justify the US government in imposing extra-territorial civil and criminal liability on third country nationals who facilitate, assist, aid or abet the violation of US economic sanctions because such sanctions laws have been interpreted as having extra-territorial effect and the facilitation and assistance of trade with US-targeted states and entities have been defined as a threat to US national interest and security and as having effects within US national territory.⁶⁰

Extra-territorial application and federal conspiracy statute

Parties who conspire in a foreign country to violate US economic sanctions may also be subject to extra-territorial third party liability based on the US federal conspiracy statutes.⁶¹ For example, a foreign national whose agreement and participation outside the United States to a scheme that violates the extra-territorial provisions of US criminal law will be subjected to the extra-territorial reach of the US conspiracy statute if the agreement and conduct entered into by the third party is 'intended to take effect' or has a direct effect in the United States.⁶² Similarly, a foreign institution with no business presence in the United States could incur liability for violating the Treasury's OFAC regulations based on the US federal statutes criminalising conspiracies to commit crimes and aiding and abetting crimes against the United States.⁶³ The Second Circuit ruled in *Melia v. United States* that the US would have jurisdiction over a party outside the United States who conspired with persons within the United States.⁶⁴ Similarly, a US District Court ruled in *United States v. Noriega* that the federal aiding and abetting and conspiracy statutes could be applied extra-territorially to overseas conduct that was defined as criminal by the underlying substantive offence.⁶⁵ The court in the *Noriega* case adopted the reasoning of the Eleventh Circuit in *United States v. Inco*

⁶⁰ See International Emergency Economic Powers Act (1977)(as amended), Pub. L. 95–223, Title II, §203, 28 Dec. 1977, 91 Stat. 1626, *amended* Pub. L. 100–418, Title II, §2502 (b)(1), 23 Aug. 1988, 102 Stat. 1371, *codified as* 50 U.S.C. §1701 (a)&(b).

⁶¹ *Chua Han Mow v. United States*, 730 F. 2d 1308, 1311 (9th Cir. 1984), *cert. den.* 470 U.S. 1031 (1985); see also, *United States v. Cotten*, 471 F. 2d 744, 750 (9th Cir. 1972), *cert. den.* 411 U.S. 936 (1973). The federal conspiracy statute has been codified at 18 U.S.C. §371 (1998). It contains two distinct clauses that create two different conspiracy offences; it states in relevant part:

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined under this title or imprisoned not more than five years, or both. (62 Stat. 701, c. 645; 25 June 1948)

⁶² Department of Justice Manual (1994–1 Supp.; citing 18 U.S.C. §1871).

⁶³ See 18 U.S.C. §2 (1998; Federal Aiding and Abetting Statute). See also, 18 U.S.C. §371 (1998; Federal Conspiracy Statute).

⁶⁴ 667 F. 2d 300 (2nd. Cir. 1981).

⁶⁵ 764 F. Supp. 1506, 1516 (S.D. Fla. 1990).

Bank & Trust Corp., where it was recognised as a well-settled principle of US criminal law that the US government has the power to prosecute every member of a conspiracy regardless of their territorial location if any act or agreement of the conspiracy occurred in the United States.⁶⁶

Extra-territoriality and the aiding and abetting statute

As discussed above, US courts have held that the US federal statute imposing aiding and abetting liability against any party who assists, commands, induces or causes another person to commit an offence against the United States would result in extra-territorial liability on foreign third parties, who would otherwise not be subject to US jurisdiction, if they have assisted or caused another person to commit a substantive offence that is based on a statute that has extra-territorial effect.⁶⁷ In addition, the majority of federal circuits have extended this principle by adopting a rule that would result in extra-territorial criminal or civil liability for foreign third parties if they wilfully cause another person to commit an offence against the United States, regardless of whether the statute on which the substantive offence was based had extra-territorial effect.⁶⁸ The leading case supporting this view is *United States v. Heyman* in which the Second Circuit held that an individual who could not be held liable for the underlying substantive offence of failing to file a currency transaction report because the statute only applied to financial institutions could be subjected to aider and abettor liability if he had assisted or caused a financial institution to commit the offence.⁶⁹ The court based its ruling on the text and legislative history of 18 U.S.C. §2 (b), which provides ‘Whoever willfully causes an act to be done which if directly performed by him or another would be an offense against the United States, is punishable as a principal’.⁷⁰

⁶⁶ 845 F. 2d 919, 923–924 (11th Cir. 1988). In this case, US conspirators had begun the conspiracy in the US, and it continued to function in the US until the US conspirators took it to the Cayman Islands where Inco bank agreed to launder money on behalf of the US conspirators. The court held that although Inco bank joined the conspiracy in the Cayman Islands and undertook no acts in US territory, it had knowingly become part of a conspiracy that would continue to operate in the United States, and thus was liable as a co-conspirator. *Ibid.*

⁶⁷ See *Felix-Gutierrez*, at 1205.

⁶⁸ See *Heyman*, 794 F. 2d at 789. In *Heyman*, the Second Circuit considered whether to impose liability on an individual who was a broker for a financial intermediary who had deliberately structured transactions so as to avoid making currency transaction reports as required by 31 U.S.C. §5313 of the Bank Records and Foreign Transactions Act and the Currency and Foreign Transactions Reporting Act (Bank Secrecy Act of 1971) *codified at* 31 U.S.C. §§5311–5328 & 12 U.S.C. §§1818 (s), 1829b and 1951–59.

⁶⁹ *Ibid.*, at 790–791.

⁷⁰ 18 U.S.C. §2(b) (2006). When it enacted this provision, Congress had intended to expand the scope of criminal liability ‘so that a person who operates from behind

In considering the proper application of §2(b), the court relied on previous cases where it had held that a defendant can be held culpable for causing a third person to commit a criminal act, even though the defendant itself lacked legal capacity to commit the substantive crime.⁷¹ The court cited the Second Circuit decision in *United States v. Wiseman* where it held that an individual could be found guilty of wilfully causing an innocent intermediary to commit a crime, where the intermediary had the capacity to commit the crime, but the defendant did not.⁷² The court also cited *United States v. Ruffin*⁷³ where the defendant (Ruffin) had fraudulently persuaded the director of a federal agency to approve contracts for the government to continue renting defendant's unfit premises. Ruffin was convicted of fraud in obtaining a government contract, although the relevant statute prohibited certain conduct only if committed by a 'director' or 'employee' of a federal agency.⁷⁴ Although the director of the agency was acquitted of all charges, Ruffin was found guilty pursuant to §2(b). In affirming the conviction on appeal, Judge Mansfield observed that §2(b) was amended by Congress in 1951 to broaden the scope of criminal liability by imputing criminal liability to anyone who 'willfully causes an act to be done which if directly performed by him or another would be an offense against the United States' (emphasis added).⁷⁵ Both *Ruffin* and *Wiseman* held that the addition of the words 'or another' reflected Congress's intent to hold criminally liable those who cause others to commit crimes, without regard to the guilt or innocence of the intermediary or the legal capacity of the defendant to commit the crime.

the scenes may be convicted even though he is not expressly prohibited by the substantive statute from engaging in the acts made criminal by Congress'. See *United States v. Ruffin*, 613 F. 2d 408, 413 (2nd Cir. 1979; citing Judge Mansfield's interpretation of Congress's intent when it amended 18 U.S.C. §2(b) in 1951 as an effort to expand the scope of criminal liability).

⁷¹ *United States v. Ruffin*, 613 F. 2d 408 (2nd Cir. 1979); *United States v. Wiseman*, 445 F. 2d 792 (2nd Cir. 1971), *cert. den.* 404 U.S. 967 (1972).

⁷² *Ibid.*, at 794–795. *Wiseman* involved two private process servers who had wilfully caused the clerk of a New York civil court to enter default judgments against parties who had in fact not been properly served. The applicable statute imposed criminal liability for such acts if committed 'under color of...law', a category that included the court clerk but not the defendants. In affirming the defendants' convictions, the Second Circuit reasoned that 'if defendants "wilfully caused" the Clerk to enter such judgments, defendants would be culpable to the same extent as the Clerk would be assuming the Clerk had the same knowledge as was possessed by defendants as to the falsity of the papers'. *Ibid.*

⁷³ 613 F. 2d 408 (2nd Cir. 1979).

⁷⁴ *Ibid.*, at 793.

⁷⁵ Before the amendment was enacted, §2(b) provided: 'Whoever wilfully causes an act to be done which if directly performed by him would be an offense against the United States, is punishable as principal'. See *Heyman*, 794 F. 2d at 791.

Accordingly, in *Heyman* because the finance company's employee (Heyman) had structured his customers' deposits so that no single transaction involved more than \$10,000, he had wilfully caused his employer (the finance company) to fail to file the appropriate currency transaction reports. Since §2(b) holds liable as a principal any person who wilfully causes an act to be done which if directly performed by another (the finance company) would be a federal offence, the employee (Heyman) is criminally liable as a principal for aiding and abetting a violation of the currency reporting statute, even though the employee had no capacity under the statute to commit the underlying offence. The rulings in *Heyman* and *Gutierrez* both support the view that criminal liability may be imputed extra-territorially to a third country national who has wilfully aided and abetted a transaction in violation of US economic sanctions.

Another important aspect of the *Heyman* case is that the court emphasised that for aider and abettor liability under section 2(b) to be imposed against the third party defendant, the defendant's acts had to be 'willful'. The court reasoned that the wilfulness requirement would provide adequate protection for third parties who may 'stumble into a violation of federal law'.⁷⁶ Indeed, the US Supreme Court has held that a defendant must have culpable intent as a necessary element of the offence for criminal liability to be imposed.⁷⁷ Although the principle of imputed criminal liability suggests that extra-territorial sanctions may be imposed on a third country financial adviser for assisting in a transaction that violated US economic sanctions, the *Heyman* case also emphasises the requirement that a third party defendant must have wilfully assisted another in violating US economic sanctions. In fact, as a preliminary issue, a third country defendant would likely assert that the US government had failed to provide adequate notice that the transaction for which the defendant was providing assistance involved an offence under US economic sanctions. Indeed, some third country nationals could argue that because of the lack of notice they do not possess the culpable intent or scienter necessary to be liable either criminally or civilly under US economic sanctions and thus the extra-territorial enforcement of such regulations violates due process. The imputation of criminal liability however will likely be justified if the foreign third party defendant has availed itself of the privileges of conducting any type of business in US territory and therefore would be presumed to be aware of the laws of the United States. The more difficult issue, however, concerns the third country person who has no business activity in US markets, but who may still be subject to extra-territorial third party liability because it knowingly advised a transaction,

⁷⁶ *Ibid.*, at 792 (citing *Village of Hoffman Estates v. the Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 499 (1982; scienter requirement mitigates a law's vagueness with respect to adequacy of notice that specified conduct is proscribed).

⁷⁷ *Boycote Motor Lines v. United States*, 342 U.S. 337, 342 (1952).

lawful under the laws of its own country, but which violated the extra-territorial provisions of US sanctions because it involved US currency or a US-controlled third country entity.

On the other hand, the US government maintains the position that all sophisticated third country persons, that is, financial institutions and international professional advisory firms, are on notice because the US government publishes a list of its targeted countries and their specially designated nationals and other targeted entities and disseminates this list around the world to government ministries, financial institutions and other business entities whose transactions are suspected of violating the extra-territorial scope of US economic sanctions.⁷⁸ The publication of this extensive list and its wide availability creates a presumption that the foreign third party knew or should have known that its assistance or aid for such transactions may be in violation of US law. The use of such an objective standard of knowledge to impose participatory liability in an extra-territorial context imposes a strict standard of commercial probity which may be in some cases impossible to achieve. Nevertheless, the US government considers sophisticated third country entities to have noticed that certain transactions and transfers involving property subject to US jurisdiction in which US-targeted states have a direct or indirect interest are prohibited and thus null and void under US law and give rise to no rights, remedies or powers that may be asserted in a subsequent dispute over claims to such property.⁷⁹ The OFAC provides information by publishing notification concerning appropriate risk management procedures that can be adopted to minimise a third country person's potential liability under US sanctions.⁸⁰ Financial institutions are advised to undertake know-your-customer due diligence review procedures to minimise their liability exposure and thus to have a good faith defence against any US government enforcement action or, possibly, a private civil action under certain provisions of the Cuban economic embargo.⁸¹ Now that it has been established that the third party liability provisions of US economic sanctions regulations may be applied and possibly enforced extra-territorially, it is necessary to discuss what prohibitions and restrictions will be applied to third country persons who assist or facilitate transactions in violation of US economic sanctions.

⁷⁸ OFAC sanctions programmes brochures are available, as well as SDN listings and updates, free in downloadable camera-ready Adobe Acrobat *PDF format over the Treasury Department's World Wide Web server. OFAC's home page site is: {HYPERLINK <http://www.ustreas.gov/treasury/services/fac/fac.html/>}

⁷⁹ See 31 C.F.R. §515.203 (a)-(d)(2006).

⁸⁰ See Office of Foreign Assets Control, *Foreign Assets Control regulations for the Financial Community* (Washington DC: 3 Aug. 2005) pp. 3-6 (Cuba), pp. 20-27 (Iran).

⁸¹ See discussion in Chapter 7 of private rights of action under US economic sanctions as authorised under Title III of the Cuban Liberty and Democratic Solidarity Act, *codified at* 22 U.S.C. §6021-6091 (1998).

US economic sanctions and third party liability

In addition to the broad application given to US third party criminal liability statutes, the International Emergency Economic Powers Enhancement Act was enacted in 2007 to enhance IEEPA's penalty provisions and also to create a specific offence for any person who violates, attempts to violate, conspires to violate any licence, order, regulation or prohibition issued under IEEPA. The IEEPA Enhancement Act reinforced existing OFAC and BIS export regulations that imposed extra-territorial third party liability on third country persons who wilfully facilitate or approve transactions in violation of US sanctions. The terms 'facilitate' and 'approve' were not generally defined in any sanctions programme until the OFAC adopted regulations in 1998 implementing sanctions against Sudan.⁸² Although the Sudanese sanctions regulations did not apply directly to the activities of foreign subsidiaries of US companies, they strictly prohibited any US person or parent company from 'approving or facilitating' otherwise permitted third country trade with Sudan. Moreover, these regulations provide OFAC's first guidance on the meaning of facilitation. Section 538.407 defines 'facilitation' as 'any action...that assists or supports trading activity with Sudan by any person'. This includes financing a trade, insuring trade, or warranting the quality of goods sold by a subsidiary to the Government of Sudan.⁸³ The regulations, however, do not prohibit certain passive activities, such as reviewing reports of a foreign affiliate's business in Sudan. These definitions of facilitative liability are consistent with OFAC's established practice under other sanctions programmes of imposing third party liability. Whilst they provide some guidance in interpreting parallel prohibitions against approval or facilitation in other sanctions regimes, OFAC views each regulatory programme as different, even to the point where similar language can have different meanings.⁸⁴

Foreign assets control regulations – third party facilitative liability

The OFAC regulations generally prohibit US banks from facilitating trade with targeted countries and entities.⁸⁵ US banks are required to 'block' or 'freeze' property in which targeted states or designated nationals have an interest.⁸⁶

⁸² See 63 Fed. Reg. 35,809 (1998), *codified at* 31 C.F.R. §538.100 *et seq.* (1998).

⁸³ 31 C.F.R. §538.407 (2006).

⁸⁴ For example, the prohibitions of the Cuban and North Korean regulations apply to US-controlled foreign subsidiaries, whereas the Iranian and Libyan regulations apply to foreign branches of US parents but not to foreign subsidiaries. See 31 C.F.R. §500 *et seq.* (North Korea); 31 C.F.R. §515 *et seq.* (Cuba); cf. 31 C.F.R. §536 *et seq.* (narcotics traffickers); 31 C.F.R. §550 *et seq.* (Libya); 31 C.F.R. §560 *et seq.* (Iran); 31 C.F.R. §§595 & 597 *et seq.* (terrorism).

⁸⁵ U.S. Office of Foreign Assets Control, 'Foreign Assets Control Regulations: The Countries Aren't Enough' (Government Information Services, Mar. 1996), 1.

⁸⁶ 'Blocking' or 'Freezing' requires a bank to impose a complete prohibition against transfers or transactions of any kind in which a targeted state or designated national or entity has an interest. 31 C.F.R. §515.319 (2006).

Property subject to blocking may include goods, deposits, funds transfers, loans, letter-of-credit contracts, drafts and negotiable instruments – essentially almost anything of value.⁸⁷ Indeed, the economic embargo programmes against Cuba and North Korea contain broad prohibitions against not only all transfers and transactions by US persons and US-controlled foreign entities with these countries and their controlled entities but also all transfers of property subject to US jurisdiction that are facilitated or assisted by any (including non-US) third party intermediary. The Burmese sanctions regulations also prohibit all ‘U.S. persons’ from approving or facilitating any new investment by non-US persons.⁸⁸ Similarly, the narcotics trafficking sanctions regulations and the terrorist sanctions regulations impose sweeping civil and criminal liability on persons who participate, assist or aid proscribed transactions. Failure to comply with these regulations may result in substantial civil and criminal penalties.⁸⁹

Cuban assets control regulations

The Cuban embargo regulations impose facilitative liability on third country financial institutions which wilfully assist or facilitate ‘[a]ll transfers of credit and all payments between’, or ‘through’, ‘any banking institution or banking institutions wheresoever located’ with respect to ‘property subject to the jurisdiction of the United States or by any person subject to the jurisdiction of the United States’.⁹⁰ The effect of the regulation is to impose liability on any financial institution that transfers any property subject to US jurisdiction (i.e., US currency, securities or negotiable instruments) in which the Cuban government, a Cuban national, or a designated Cuban-controlled entity (such as a cloaked US or third country corporation) has any direct or indirect interest, irrespective of where the transaction occurs. The financial intermediary also incurs liability if it transfers *any* property or property interest in which a US-controlled person (including a banking institution) has an interest if the transaction was ‘by, or on behalf of, or pursuant to the direction of’ the Cuban government or its nationals, or if the property in question has been subject to a direct or indirect interest by

⁸⁷ This means no payments, transfers, withdrawals, or other dealings may take place with regard to blocked property unless authorised by OFAC. See Cuban Assets Control Regulations (CACRs), 31 C.F.R. §500.319. Banks are permitted to take normal service charges. 31 C.F.R. §§500. 310 & 311 (Foreign Assets Control Regulations directed against North Korea).

⁸⁸ 31 C.F.R. §537.314 (1998). These regulations were based on President Clinton’s executive order in May of 1997 banning new investment in Burma. See Exec. Order No. 13,047 (20 May 1997), available in 1997 WL 272472.

⁸⁹ Depending on the programme, OFAC has independent authority to impose civil penalties of up to \$250,000 per count, while criminal violations can result in corporate and personal fines of up to one million US dollars and twelve years in prison. See e.g., 31 C.F.R. §§515.701; 575.701; 560.701; 550.701 & 575.701.

⁹⁰ Cuban Assets Control Regulations, 31 C.F.R. §515.201 (a)(1) (2006).

the Cuban government at any time since the effective date of the sanctions.⁹¹ Further, a US-controlled foreign bank may not deal in ‘transfers, withdrawals, or exportations of, any property or evidences of indebtedness or evidences of ownership of property’ if such transactions involve property in which the Cuban government, its nationals or designated entities have had ‘at any time on or since the effective date... any interest of any nature whatsoever, direct or indirect’.⁹² Moreover, section 515.201(b)(2) extends the extra-territorial effect of this liability to non-US-controlled third party intermediaries in regard to ‘[a]ll transfers outside the United States with regard to any property or property interest subject to the jurisdiction of the United States’⁹³ if such property or property interest has been subject to an interest, direct or indirect, of a targeted state or national since the effective date of the sanctions. By prohibiting all transfers outside the United States in respect to property subject to US jurisdiction in which the Cuban government has (or has had) an interest, third country intermediaries who maintain, possess or who are involved merely as conduits through which such property is transferred are exposed to liability under US sanctions. Furthermore, the structuring of transactions by any person (US or foreign) ‘for the purpose or which has the effect of evading or avoiding any of the prohibitions set forth’ is also prohibited.⁹⁴ This latter provision expands the scope of third party liability coverage from financial intermediaries to those who would be involved in advising and structuring transactions to avoid prohibitions under the regulations. All such transfers of property undertaken by third party intermediaries will be null and void and unenforceable

⁹¹ The relevant section states: ‘All of the following transactions are Ibid. prohibited,’ ... ‘if either such transactions are by, or on behalf of, or pursuant to the direction of a foreign country designated under this part, or any national thereof, or such transactions involve property in which’ [Cuba or Cuban national] ‘has at any time on or since the effective date of this section had any interest of any nature whatsoever, direct or indirect: (1) All transfers of credit and all payments between, by, through or to any banking institution or banking institutions wheresoever located, with respect to any property subject to the jurisdiction of the United States or by any person (including banking institution) subject to the jurisdiction of the United States’; Ibid.

⁹² 31 C.F.R. §515.201(b)(1) (1998).

⁹³ 31 C.F.R. §515.201(b)(2) (1998). The relevant section states: ‘All transfers outside the United States with regard to any property or property interest subject to the jurisdiction of the United States’ are ‘prohibited’ ... ‘if such transactions involve property in which any foreign country designated under this part, or any national thereof, has at any time on or since the effective date of this section had any interest of any nature whatsoever, direct or indirect’. Ibid.

⁹⁴ 31 C.F.R. §515.201(c). Similarly, the Libyan Sanctions Regulations prohibited ‘[a]ny transactions for the purpose of, ... evading or avoiding any of the prohibitions set forth in this subpart. 31 C.F.R. §550.208 (1998). See also, Iranian Transaction Regulations, 31 C.F.R. §560.203.

in any US action to enforce any right, obligation or privilege arising from such transfers.⁹⁵

For example, a French bank which provides financing for a joint venture between a US-controlled French company and a Cuban state agency involving the development of confiscated Cuban property would likely violate the facilitative and knowing assistance provisions of the Cuban embargo regulations.⁹⁶ The basis of such third party liability would derive from the bank's role as financial intermediary in facilitating a transaction between a US-controlled French company and the Cuban government in violation of §515.329, which prohibits US-controlled entities, wherever they may be located, from trading with the Government of Cuba, its nationals or specially designated entities.⁹⁷ Assuming that US jurisdiction could not be imposed because non-US currency was being used in the transaction and the French bank was not otherwise subject to US regulatory supervision as discussed in Chapter 5, the question arises what basis of extra-territorial jurisdiction would be used to impose third party liability against the French bank for facilitating this transaction. Indeed, the French bank would contend that they are not subject to US jurisdiction because they are not a US person as that term is defined in section 515.329 and that therefore the US government has no authority to impose extra-territorial jurisdiction on it for assisting the transaction. The basis of liability, however, would be found in section 515.201(b)(2), which prohibits '[a]ll transfers outside the United States with regard to any property or property interest subject to the jurisdiction of the United States'.⁹⁸ In this case, the French bank would be subject to liability because it assisted or facilitated the transfer outside the United States of a property interest subject to US jurisdiction because the property involved in the transfer was owned by a US-controlled French company.

All such regulated banks under the Cuban embargo regulations are required to exercise caution in order not to handle knowingly or process unlicensed transactions in which Cuba has an interest. No US bank, no overseas branch or subsidiary of a US bank, may even advise a letter of credit involving the Cuban government or Cuban persons, nor may it process documents referencing Cuba. All such property must be blocked as soon as it comes within the banks' possession or control. In addition, all transfers of credit and all payments between or through 'any banking institution or banking institution wheresoever located' without a licence is prohibited if

⁹⁵ 31 C.F.R. §515.203 (e).

⁹⁶ See 31 C.F.R. §515.203 (1998).

⁹⁷ 31 C.F.R. §515.329 (a)–(d) (1998). See Chap. 5. Moreover, because the transaction involved confiscated Cuban property that formerly belonged to a US person, the bank would be exposed to civil liability for benefiting from the use of confiscated Cuban property under Title III of the Helms-Burton Act. See discussion of the Cuban Liberty and Democratic Solidarity Act (Helms-Burton) in Chapter 7.

⁹⁸ 31 C.F.R. §515.201 (b)(2).

such transfers involve property subject to US jurisdiction or if the transfer is undertaken by any person subject to US jurisdiction.⁹⁹ For example, this sweeping provision would require a non-US controlled French bank to freeze US dollar assets in its Paris branch if they were holding such assets for a German company that was defined by US regulation to be Cuban-controlled or acting on behalf of the Cuban government or a Cuban national. For liability to be imposed on a third country entity, however, the US government must establish that the defendant had the requisite level of culpable knowledge while undertaking the prohibited acts or omissions.

Third party liability – Helms-Burton’s visa blacklist

The blacklist mechanism was strengthened with respect to Cuba when Congress enacted the visa blacklist provisions of Title IV of the Helms-Burton Act. The Helms-Burton Act goes beyond the expansive notions of deemed nationality under the Cuban Assets Control Regulations for those who act on behalf of Cuba or Cubans. In addition to imposing potential civil liability on third country nationals who allegedly traffick in confiscated Cuban property, the Act also authorises the denial or revocation of visas to such individuals or officials of companies, as well as their families.¹⁰⁰ Once a determination is made by the Assistant Secretary of State for Inter-American affairs as to the visa ineligibility or excludability of third country nationals for trafficking in confiscated property, the names and addresses of the designated individuals, along with their spouses and children, are entered into the ‘visa lookout’ and ‘entry exclusion’ systems of the Immigration and Naturalization Service (INS); this results in the denial of any visa application and revocation of any existing visas. In certain circumstances, the decisions regarding visa ineligibility or excludability may not be disclosed to the public, but as a general matter the State Department will release the names of the individuals and companies with whom the excluded individuals are associated.¹⁰¹ By doing this, the general public is placed on notice that those designated individuals and firms are deemed by the US government to be trafficking in confiscated property with the result that those who deal with them may incur civil liability under Helms-Burton.

⁹⁹ 31 C.F.R. §515.201(a)(1); See §515.329(a)-(d)(persons subject to US jurisdiction).

¹⁰⁰ See 22 U.S.C. §6091 (2006).

¹⁰¹ 61 Fed. Reg. 30, 656 (1996). One of the purposes of Title IV of Helms-Burton is to deter potential investment in confiscated property by placing the public on notice that civil liability will attach through commercial activity with such property. See 22 U.S.C. §6022(6). However, there is no SDN-like public list to identify specifically ‘traffickers’ in confiscated property as defined under Title III of the Act; instead the Inter-American Affairs Division of the State Department uses an internal procedure which relies, in part, on outside sources to identify those subject to visa restrictions. See ‘Guidelines Implementing Title IV of the Cuban Liberty and Democratic Solidarity Act (LIBERTAD) Act of 1996’, 61 Fed. Reg. 30,665 (1996).

Knowledge

Liability may be imposed on the third party facilitator, participant or assistant if it has the requisite knowledge to satisfy one or both of the following standards: (1) wilfulness or actual knowledge; or (2) a reasonable cause to know.¹⁰² These standards are set forth in subsection 515.203(d)(1)&(2), which provides that any transfer of property that would otherwise be null and void, or unenforceable, by virtue of provisions in US sanctions regulations shall not be deemed so as to any person with whom such property was held or maintained in cases where such person is able to establish each of the following: (1) such transfer represented no wilful violation of the relevant sanctions programme; (2) the person with whom such property was held had no reasonable cause to know or suspect, in view of all the facts and circumstances known or available to such person, that such transfer required a licence; and (3) that promptly upon discovery the defendant disclosed by reporting such transfers or transactions to the OFAC. This three-pronged test is a limited safe harbour for transactions or transfers otherwise deemed null and void because they involve property owned or controlled by targeted states or entities. Under the first prong, the wilfulness standard suggests a subjective approach for determining the necessary *mens rea* to impose third party accessory liability.¹⁰³ Such an approach requires the government to prove actual knowledge, or at least a wilful shutting of one's eyes to the obvious.¹⁰⁴ Although criminal law requires 'intention' or 'recklessness', these elements may be inferred if the defendant has significant knowledge of factual details of a particular transaction in which it was involved. The necessary *mens rea* will be difficult to prove because of the subjective standard of intent used in the criminal law and the various complex issues that are likely to arise in the context of imposing accessory liability on an extra-territorial basis.¹⁰⁵

The second prong adopts the more objective reasonable person standard in which the intermediary must show that it did not have 'reasonable cause to know or suspect, in view of all the facts and circumstances known or

¹⁰² 31 C.F.R. §515.203 (d)(1)&(2).

¹⁰³ Although it uses the terminology of 'intention' and 'recklessness', the criminal law is generally concerned with the subjective knowledge of the defendant. *Reid* [1992] 3 All ER 673 (HL).

¹⁰⁴ Complicity liability has been the subject of extensive analysis which recognises the extreme complexity in devising an appropriate level of mental culpability to justify criminal sanction (Smith, 1991, Chs 6–8).

¹⁰⁵ At first glance, the wilfulness standard appears to be subjective and based on the notion of actual knowledge, which would be difficult indeed to prove against a third country person who could claim that it was not aware of the circumstances surrounding the illegal nature of a transfer involving US property with a US-targeted state.

available to such person, that such transfer required a license'.¹⁰⁶ Since the US government disseminates regulatory information in a variety of ways (including electronic networks) to all financial institutions operating on a global basis or with US dollar accounts, it will be difficult for financial intermediaries to demonstrate based on a reasonable person standard that they were not aware of whether any of their customers were specially designated nationals. The reasonable person test increases the third country intermediary's civil and criminal liability exposure to an OFAC enforcement action based on its failure to act on available information showing that it held property or assets for a specially designated national or targeted state.¹⁰⁷ It is also important to note that when OFAC brings a civil enforcement action against a third party intermediary for facilitating the transfer of such tainted property, the burden of proof shifts to the intermediary to demonstrate all three of the above elements of the safe harbour test.¹⁰⁸ Once the intermediary satisfies its burden, OFAC must produce evidence to rebut the intermediary's evidence of compliance.

In evaluating these standards, an important issue will be how much detail must the third country accessory know about the underlying transaction that violated US sanctions. For criminal liability it will be insufficient that an illegal venture was generally considered, for there must be knowledge of the type of activity that was undertaken. However, in a civil enforcement action, it may be sufficient that the third country intermediary had a general knowledge that the transaction or transfer it facilitated involved property of a targeted state or national. Moreover, in criminal and civil proceedings involving extra-territorial violations, it will be difficult to establish culpable intent on the part of a third country financial intermediary that financed a transaction involving property subject to US jurisdiction but which was also subject to a concealed interest of a targeted state government that was cloaked by a third country corporation. When considering third party liability for financial intermediaries, however, the OFAC regards all foreign banks that hold property subject to US jurisdiction or that conduct transactions with US-controlled persons to be on constructive notice that they will be subject to third party criminal and civil liability if they are knowingly

¹⁰⁶ 31 C.F.R. §515.203(d)(1)&(2). Subsection 203(d)(2) states: 'The person with whom such property was held or maintained did not have reasonable cause to know or suspect, in view of all the facts and circumstances known or available to such person, that such transfer required a license...'

¹⁰⁷ 31 C.F.R. §515.203 (d)(1).

¹⁰⁸ See OFAC Regulations, 31 C.F.R. §515.701–705(civil & criminal proceedings); BIS Regulations, 15 C.F.R. §76–41–6 (Criminal Sanctions); 15 C.F.R. part 766 (Administrative Enforcement Proc.). OFAC may institute criminal proceedings against any intermediary whom it determines has not complied with §203 (d)(1)&(2). This study will not address in any depth the issues arising from parallel civil, criminal and administrative enforcement proceedings.

concerned in transactions involving a transfer of property subject to a direct or indirect interest of a targeted state or of any apparently neutral third country entity that is designated by OFAC as an organisation that acts for or on behalf of a targeted state.

Notwithstanding the sophisticated techniques of information dissemination used by OFAC to inform third country intermediaries and professional advisers of the prohibitions and restrictions of US sanctions programmes, it will be extremely difficult in a criminal proceeding to prove that the third party intermediary acted wilfully in facilitating a transaction or transfer involving tainted property. In civil or administrative actions, however, because the burden is on the intermediary to demonstrate that it did not act wilfully and that it could not reasonably suspect that such property was tainted, the ability of the intermediary to produce sufficient evidence to satisfy its burden will determine whether the government can prevail.¹⁰⁹ Indeed, in cases involving extra-territorial violations, it may be difficult for the intermediary to satisfy this burden because it might have to produce evidence or witnesses in a country that has laws prohibiting compliance with extra-territorial US regulations. In such a case, the intermediary may incur civil sanctions because it was unable to demonstrate its compliance with US regulation.

In addition, the OFAC regulations impose facilitative criminal liability on officers, directors or agents of corporations who 'knowingly participate' in any transactions or transfers in violation of US sanctions.¹¹⁰ Since these are criminal penalties, OFAC will have to show beyond a reasonable doubt that the defendants 'knowingly participated' in prohibited transactions. Moreover, any person who uses fraud to conceal any violation of the regulations or who 'knowingly and willfully' falsifies, conceals or 'makes any false, fictitious, or fraudulent statement' or 'uses any false writing or document' in relation to a violation of US law shall be subject to fines or imprisonment.¹¹¹

Moreover, although these third party liability provisions are not expressly extra-territorial, the Ninth and Second Circuits' rulings in *Felix-Gutierrez*, *Heyman*, and *Melia* upholding the extra-territorial application of US third party criminal liability statutes on those who assist, procure, aid or abet the violation of US law will likely result in US courts also upholding the extra-territorial application of third party liability under US sanctions. This may well result in extra-territorial criminal liability for third country persons

¹⁰⁹ If the government does prevail in civil proceedings, it can impose monetary fines or revoke any licences issued by the US government to do business. See 31 C.F.R. §§500.703–708.

¹¹⁰ 31 C.F.R. §515.702(1).

¹¹¹ 31 C.F.R. §515.702 (d; expressly incorporating 18 U.S.C. §1001 prohibitions against false statements).

who wilfully facilitate or assist US commercial dealings with targeted states and entities.

Multi-national financial institutions should be aware that US sanctions extend beyond the territorial borders of the targeted countries and should therefore instruct their letter-of-credit operations to be aware not only of certain US-targeted states but also the names of numerous front organisations that are designated by OFAC as specially designated nationals. Indeed, OFAC's master list of SDNs and blocked persons contains over five thousand names of organisations, companies, vessels, entities and persons throughout the world.¹¹² For example, if a third party intermediary anywhere becomes aware of facts to suggest that it is facilitating a transaction involving US-connected property with Bank Saderat or Bank Mellī in Iran or their foreign subsidiaries or branches, all transfers or credit and all payments between banking institutions and other parties wherever located must be frozen and property involved in the transaction subject to US jurisdiction must be blocked because these banks are designated as supporting Iran's nuclear weapons programmes. Similarly, banks cannot advise letters of credit involving US property or currency listing Drogas la Rebaja, a major drug store chain in Colombia, as an account party because of its connection to international narcotics trafficking. It is, therefore, crucial for letter-of-credit professionals to be familiar with OFAC's SDN list.¹¹³

Some precautionary measures that a financial institution may undertake to minimise civil and criminal liability for knowing assistance and participation under US sanctions are the following. Before any bank issues, confirms, amends or even advises a letter of credit, it should examine the instrument carefully to discern any facts that would make the bank aware of any possible violations of US sanctions. For example, the account party, beneficiary, issuing bank or confirming bank should not be a blocked party that would be listed on the OFAC SDN list. The bank should confirm whether the underlying transaction involves a targeted country or specially designated national, or whether the transaction involves property subject to US jurisdiction in which event the intermediary will be liable for participating in a transaction using such property with a targeted state. A bank should observe other patterns of activity such as whether the bill of lading indicates goods that were shipped by a blocked merchant vessel. Whilst it is unlikely that an individual's name from OFAC's SDN list will appear on documents related to a letter of credit, it is quite possible that illicit ships or

¹¹² See Office of Foreign Assets Control, 'Specially Designated Nationals and Blocked Persons' (13 May 1998).

¹¹³ Most major financial institutions, seeking to ensure that illicit transactions are not processed, have begun using sophisticated name-recognition 'interdict' software to block questionable transactions automatically. Some of the filters contain all names on OFAC's SDN list along with geographical names for embargoed countries and cities (Tuchband, 1999).

shipping companies may be referenced. If a bank has reason to believe that a letter of credit involves an interest of a target country or an SDN, to avoid liability it should treat the letter-of-credit contract itself and all related documents as blocked property. It must secure drafts and other negotiable instruments; and depending on the status of the letter of credit, it may be required to debit its customer's account and block the letter-of-credit payment. In any event, it should perform no further services with regard to the letter of credit until it obtains a licence or other authorisation from OFAC.¹¹⁴

The aftermath of September 11

On 23 September 2001, President Bush issued Executive Order 13,224 entitled 'Blocking Property and Prohibiting Transactions with Persons who Commit, Threaten to Commit, or Support Terrorism'. This Executive Order expanded the list of designated terrorist organisations to include over thirty individuals and organisations that have allegedly committed, or been involved in, acts of terrorism.¹¹⁵ All persons subject to US jurisdiction are required to block or freeze any assets being held on behalf of such persons and to notify OFAC accordingly. The Order also prohibits all foreign third parties from assisting or providing material support for, or associating with, designated terrorists. The Order observes that the global reach of terrorist financing made it necessary to impose extra-territorial financial sanctions against all 'foreign persons that support or otherwise associate with these foreign terrorists'.¹¹⁶

Section 1 of the Order blocks indefinitely any obligation to perform a contract entered into before the effective date of the Order with a designated terrorist entity or person listed in the Order, and requires all property or interests in property to be blocked of such designated persons that are located in the United States or that hereafter come within the US, or that come within the possession or control of a US person. The Secretary of the Treasury, in consultation with the Secretary of State and the Attorney

¹¹⁴ See Office of Foreign Assets Control, *Foreign Assets Control regulations for the Financial Community* (Washington, DC: 3 Aug. 2005) pp. 3–6 (Cuba), pp. 2027 (Iran).

¹¹⁵ Some of the groups and individuals designated include the Al Qaida/Islamic Army organisation and Osama bin Laden. See Exec. Order 13224 (23 Sept. 2001), Annex.

¹¹⁶ Exec. Order 13224, preamble (24 Sept. 2001) The Order provides a broad definition of terrorism that provides: an activity that – (1) involves a violent act or an act dangerous to human life, property, or infrastructure; and (2) appears to be intended – (A) to intimidate or coerce a civilian population ; or (B) to influence the policy of a government by intimidation or coercion; or (C) to affect the conduct of a government by mass destruction, assassination, kidnapping or hostage-taking.

General, has authority to determine which 'foreign persons' have committed or pose a significant threat of committing 'acts of terrorism that threaten the security of US nationals or the national security, foreign policy, or economy of the United States'.¹¹⁷ Moreover, the Secretary of the Treasury may make determinations that certain foreign persons in third countries are 'owned or controlled by', or 'act for or on behalf of' foreign persons designated by the US to be terrorists.¹¹⁸ Moreover, section 1(d) of the Order expressly creates extra-territorial third party liability by authorising the Secretary of the Treasury, after consulting with other US government officials and with 'foreign authorities, if any', to designate foreign persons who 'assist in, sponsor, or provide financial, material, or technological support for, or financial or other services to or in support of, such acts of terrorism or those persons listed' to be terrorists. All US trade, commerce or transactions with such third party persons would be prohibited unless a licence is obtained from OFAC, and they would be subject to civil and criminal sanctions under US law if they have a constitutional presence in the US.

The Order also prohibits any transaction or dealing by US persons, or by foreign persons within the US, in property or interests in property blocked pursuant to this Order, including but not limited to 'the making or receiving of any contribution of funds, goods, or services to or for the benefit of those persons listed' as terrorists in the Order.¹¹⁹ This provision prohibits the right of US persons to make contributions of any type or to perform any type of service on behalf of a listed terrorist or a person or entity operating in a foreign country which the US has decreed to be owned or controlled by a listed terrorist. Moreover, any effort by a US person (or by a non-US person within the US) to undertake a transaction to restructure the ownership or control of property or a business entity in order to evade or avoid restrictions under the Order is prohibited and may attract both civil and criminal liability not only for financial institutions or companies holding property on behalf of listed terrorists but also for the professionals advising such transactions.¹²⁰ Moreover, any conspiracy formed to violate any of the prohibitions in the Order is prohibited and has extra-territorial effect through the Federal Conspiracy statute.¹²¹

Section 6 states the importance of US cooperation with foreign governments in implementing the Order by providing that the Secretary of State and the Secretary of the Treasury and other government agencies 'shall make all relevant efforts to cooperate and coordinate with other countries'

¹¹⁷ s. 1(b).

¹¹⁸ s. 1(c).

¹¹⁹ s. 2(a).

¹²⁰ s. 2(b).

¹²¹ s. 1(c). See as amended 18 USC §371 (2000); see also *United States v. Inco Bank & Trust Corp.*, 845 F. 2d 919, 923–924 (11th Cir. 1988).

and may invoke existing bilateral and multilateral agreements and arrangements to achieve the objectives of the Order. This would include the prevention or suppression of acts of terrorism, and the denial of financing and financial services to terrorists and terrorist organizations, and the sharing of intelligence regarding funding activities in support of terrorist groups. It should be noted that the principle of 'cooperation and coordination' in section 6 appears to be mandatory only to the extent that US government officials may determine what efforts at co-operation and co-ordination are 'relevant efforts' to achieve the objectives of the Order. Essentially, the US government will not be precluded from acting unilaterally whenever it perceives that it is necessary to do so.

The Order departs slightly from other US sanctions programmes by defining the term 'United States person' to mean any US citizen, permanent resident alien, entity organised under the laws of the United States (including foreign branches), or any person in the United States. In an extra-territorial sense, this is a less sweeping definition than those adopted under the Cuban and North Korean Sanctions Programmes that define US person more broadly to include any foreign person deemed by the US government to be controlled by a US citizen, resident or US business entity. Under these programmes, a US person could be defined as a company incorporated under the laws of a foreign state whose shares are subject to significant US ownership or control.¹²² The Executive Order is a significant extension of extra-territorial third party liability for foreign banks, companies and individuals who conduct, facilitate or assist transactions involving US-designated terrorist organisations. OFAC is expected in the near future to issue regulations that describe in more detail how the Order will be applied and enforced.

Contract breach and foreign illegality

Foreign companies and investors with bank accounts and operations in the United Kingdom might also have some legal defences under English law against enforcing extra-territorial US economic sanctions that take the form of blocking or freeze orders. In the 1980s, several lawsuits were filed against the foreign branches of US banks in London and Paris seeking performance of banking contracts entered into by Libyan and Iranian business entities who were subject to extra-territorial OFAC blocking orders. Although the Iranian cases in London and Paris were both settled when the US and Iran agreed to the Algiers Agreement in 1981 that resolved the hostage crisis, the Libyan cases were adjudicated in English courts with decisions handed down in 1987. A summary of the legal issues and judicial decisions follows.

¹²² 31 CFR §515.329 (a)–(d)(Cuban Asset Controls; 2000); 31 CFR §500.329(a)–(d) (2000).

Contract law defences – frustration

The English law of frustration of purpose is stated in section 1 of the Law Reform (Frustrated Contracts) Act 1943, which provides that where an English contract has become impossible of performance or otherwise been frustrated, thus resulting in the parties being discharged from any further performance, the parties shall be entitled to recover '[a]ll sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged'.¹²³ This statutory provision was the basis for one of the claims in *Libyan Arab Foreign Bank v. Bankers Trust Co.*,¹²⁴ where the extra-territorial application of US economic sanctions against Libya had resulted in a freeze order against 'all property and interests in property of the Government of Libya, its agencies, instrumentalities and controlled entities' that were in the 'possession or control of U.S. persons including overseas branches of U.S. persons'.¹²⁵ Bankers Trust complied with the order by blocking over three hundred million US dollars that they were holding in accounts in their New York and London branches on behalf of the Libyan Arab Foreign Bank (LAFB).¹²⁶ After US sanctions went into effect against Libya on 8 January 1986, LAFB demanded payment in cash (US dollars or sterling) or, in the alternative, a banker's draft for the amount of the credit in its account at Bankers Trust's London branch. Bankers Trust claimed that it was impossible for them to comply with their customer's demand because to do so would have required them to violate US economic sanctions laws.¹²⁷ They further asserted that the imposition of sanctions was a fundamental change in circumstances that involved a radical change of the obligation originally undertaken.

¹²³ Law Reform (Frustrated Contracts) Act 1943 s.1.

¹²⁴ [1989] 1 QB 728, 771–772.

¹²⁵ *Ibid.*, p. 732 (citing President Reagan's Executive Order dated 8 January 1986).

¹²⁶ LAFB's contract with Bankers Trust required LAFB to keep a minimum of \$500,000 (peg level) in its New York current account and each afternoon at 2 pm any excess amount exceeding the \$500,000 peg was required to be wire transferred to its London demand account. On the afternoon of 7 January 1986, LAFB had \$161.4 million in excess of the peg in its New York account, but Bankers Trust failed to transfer the money, even though the presidential order imposing sanctions had not yet gone into effect. After the sanctions order went into effect at 4 pm on 8 January, Banker's Trust responded to the Libyan's demand for return of its money at the bank's London branch by arguing that it could not release the funds because to do so would require inter-bank transfers in US dollars through the New York Clearing House Inter-Bank Payments System (CHIPS) and that because of the freeze order it was illegal to transfer the credits in US dollars through the US clearing system. Banker's Trust argued that because of supervening illegality, it could not perform its obligations under the contract. See *Ibid.*, pp. 730–734.

¹²⁷ *Ibid.*

In the ensuing civil action, LAFB asserted several causes of action, one of which was based on the Law Reform (Frustrated Contracts) Act 1943 in which they argued that Bankers Trust's defence based on frustration and impossibility by reason of economic sanctions was precluded by section 1 of the Act. Staughton, J rejected this argument by stating that section 1 required that a party's obligation to perform had to be discharged in order for another party to recover sums already paid pursuant to the contract; but in this case the effect of the blocking order had been to suspend, and not to discharge, the contractual obligations of Bankers Trust to pay plaintiff's claim.¹²⁸ Accordingly, because the defendant's obligations had been suspended and not discharged for the period the sanctions remained in effect, the contract as a whole had not become impossible of performance or otherwise frustrated.¹²⁹ Moreover, Justice Staughton observed that no restitutionary claim could prevail at common law because the consideration given by Bankers Trust had not totally failed because the bank remained under US law obliged to pay the amount owed to the plaintiff at some time in the future whenever the sanctions were lifted with interest added to the claim.

The doctrine of foreign illegality

The doctrine of foreign illegality under English contract law raises important issues regarding the potential civil liability of a bank or company operating in the UK but whose head office is based in the US and thus subject to extra-territorial US blocking orders. For instance, in *Libyan Arab Foreign Bank v. Bankers Trust*,¹³⁰ the UK branch of a US bank was subject to a contractual claim governed by English law for breach of contract brought by a Libya bank for a total withdrawal of its US dollar deposit account according to the provisions of its banking contract. In this case, Bankers Trust pleaded foreign illegality as a defence against a claim by the plaintiff LAFB for damages and recovery of over three hundred million US dollars that had been frozen in its London and New York accounts by Bankers Trust acting upon blocking orders issued by the US government against Libya in January of 1986.¹³¹ Justice Staughton recognised the major issue to be what law was

¹²⁸ *Ibid.*, p. 772.

¹²⁹ *Ibid.* Moreover, Justice Staughton found that plaintiff's frustration claim based on section 1 of the Act should be denied because the Libyan bank had not 'paid' money into their account 'in pursuance of the contract' because the deposit had been voluntary and not part of a contractual obligation. *Ibid.*

¹³⁰ [1988] 1 QB 728. See also, *Libyan Arab Foreign Bank v. Manufacturers Hanover Trust (No.2)*, [1989] 1 Lloyd's Rep. 608 (application of foreign illegality principle to case involving analogous facts).

¹³¹ *Libyan Arab Foreign Bank*, 1 QB p. 732. President Reagan had issued the order to freeze 'all property and interests in property of the Government of Libya, its agencies, ... and controlled entities', that were under the control of US persons or US-controlled foreign entities.

the proper law of the banking contract. Further, he observed that defendants could only be excused from performance if such performance was illegal under the proper law of the contract *or* if it involved doing an act which was unlawful in the place where the contract was required to be performed.¹³² Bankers Trust argued that New York law governed the contract because the account was denominated in US dollars and the parties had intended the law of New York to apply to plaintiff's London account. Accordingly, they asserted, the imposition of US economic sanctions made it illegal under the proper law of the contract for the US bank's London office to honour LAFB's demand for their money. The defendant US bank further argued that, even if English law applied to the contract, complying with plaintiff's demand would have 'necessarily involved' the doing of an illegal act in the US, namely, the transfer of US dollars credits by Bankers Trust's New York office on the US interbank payments system in violation of US blocking orders. Plaintiff argued that the proper law of the contract governing the London account was English law, and since LAFB had demanded that Bankers Trust transfer the money in either US dollars or sterling there was no violation of foreign illegality based on English public policy because Bankers Trust had a choice as to whether it wanted to perform the contract by transferring US dollars credits in New York or by paying in sterling in London.

Staughton, J ruled that the rights and obligations of the parties with respect to the London account were governed by English law (*lex loci solutionis*) and because the contract contained no express or implied term that payment must be made in US dollars, plaintiffs were entitled to demand cash payment in US dollars or sterling or by account transfer in London, which they had done.¹³³ Accordingly, plaintiff's demand for cash in London was an assertion of its right under English law and delivery by the defendant of the amounts claimed would not necessarily involve illegal action in New York. Defendant had a choice in how to discharge its obligation: they could either make payments in a manner that required illegal acts in New York in violation of US sanctions, or they could make payments in cash sterling or by account transfer in London, and thereby avoid committing any illegal acts in the United States. Consequently, the court rejected defendant's argument that the contract had become impossible or frustrated because of supervening illegality that necessarily involved illegal acts in a foreign country. Justice Staughton held that it was not an express or implied term of the contract that defendant pay plaintiff in US dollars in New York, and therefore the defendant's option to perform its obligations under the contract in a manner that would involve an illegal act in a foreign and friendly country could not be used as a defence against performance based on foreign illegality.

¹³² *Ibid.*, at 743 citing *Euro-Diam Ltd. v. Bathurst* [1987] 2 WLR 1368, 1385.

¹³³ *Ibid.*, pp. 731–733.

The significance of the *Bankers Trust* case for the doctrine of foreign illegality and the extra-territorial application of US economic sanctions seems to be that an English court has now recognised that US economic sanctions may be extended to cover third country transactions involving third country nationals and targeted entities where payment obligations between the parties are expressly or impliedly denominated in US dollars. Moreover, even if English law is the governing law of the contract, Justice Staughton stated that the supervening illegality of US economic sanctions would make the contract unenforceable as a matter of English public policy, but only if the contract expressly or impliedly provided that payment obligations could only be discharged in US dollars. Foreign parties subject to unilateral US economic sanctions in a foreign jurisdiction may want to ensure that whatever US dollar assets they are subject to payment obligations that can be discharged in a foreign currency other than the dollar, preferably the currency of the jurisdiction where the account was opened and maintained.

Conclusion

This chapter has analysed some important principles of third party liability in the major common law systems and how they may be applied extra-territorially under economic sanctions laws. The third party liability provisions of the US criminal code and sanctions regulations are an important part of the US government's policy of imposing extra-territorial sanctions to deter multi-national financial institutions and professional advisory firms from participating in or facilitating international trade with US-targeted states and entities. Indeed, US courts have held that the federal accessory and aiding and abetting statutes may be imposed extra-territorially on foreign nationals who assist, aid or abet any criminal offence under US federal law. English law principles of third party liability are not as wide reaching and have not been interpreted as having extra-territorial effect, except in narrow cases under the Anti-Crime Security and Terrorism Act 2001 where third party financial support outside the UK for terrorism committed in the UK attracts criminal liability. The knowingly concerned principle provides the doctrinal basis for UK third party liability for financial sanctions and other regulatory breaches. UK and US enforcement actions and court rulings have established standards that have increased the regulatory and legal risks for third party banks and other lending institutions and professionals who finance or facilitate transactions directly or indirectly with targeted states or their nationals. In addition, OFAC regulations against specially designated global terrorists have refined the concepts of third party liability and how they apply to anyone anywhere who is assisting a designated terrorist.

Moreover, third party liability can be imposed against the overseas branches and offices of banks and corporations that are subject to extra-territorial sanctions orders but which may violate the laws of foreign

countries. Although the doctrine of foreign illegality might provide a defence against the enforcement of a contract whose terms could violate the laws of a foreign and friendly country, English case law suggests that this could only occur in certain narrow circumstances which could potentially violate English public policy and any applicable blocking statutes.

7

Private Attorneys General and Economic Sanctions

Introduction

Economic sanctions have traditionally been analysed from the perspective of inter-state relations in which states seek to restrict trade or deny other economic benefits to targeted states and their nationals to achieve political objectives. The role of government in imposing economic costs against targeted states for breaches of international law or infringing foreign policy or national security interests has been the usual framework through which to analyse and assess a country's economic sanctions policy. US economic sanctions policy, however, began to depart from this model in the 1990s when the Congress enacted a set of statutes that created legal remedies for individuals and entities to enforce either international law or domestic law rights in US court by pursuing civil actions for damages, compensation and restitution against foreign states, third country persons and international terrorists. The creation of these private remedies was deliberately intended by Congress to create alternative legal channels through which US sanctions could be applied.

This chapter examines US economic sanctions through the use of private legal remedies which allow both US and non-US persons to assert legal claims in US courts against foreign states, business entities and individuals. The Torture Victim Protection Act of 1991 and the Anti-terrorism and Effective Death Penalty Act of 1996 provide private rights of action for individuals who have suffered damages from torture, extrajudicial killing and terrorism to bring actions in US court against foreign states and individuals who perpetrate such acts under state authority. These statutes substantially restrict foreign sovereign immunity for targeted states and their officials and thereby have spawned a number of lawsuits against states, such as Burma, Cuba, Iraq, Iran, Syria, Libya and Sudan for damages and losses arising from state-sponsored terrorism. Moreover, the 1996 Cuban Liberty and Democratic Solidarity Act

(Helms–Burton Act)¹ was adopted to reinforce the US embargo against Cuba by creating a private right of action for US nationals or residents with claims to confiscated Cuban property to assert claims for compensation against any person anywhere in the world who has economically benefited from the use of such property. The private rights of action that are available under these laws will be evaluated from a procedural perspective that explains their role as instruments of US policy and some of the issues they raise for targeted states and their nationals and third country states and persons who facilitate or are involved in commercial transactions with US targeted states.

These laws have caused considerable diplomatic complications between the US and its trading partners because the extra-territorial nature of these sanctions and their specific focus on specially designated nationals and third country nationals of states with whom the US has no direct dispute have brought US law into conflict with the laws of other national jurisdictions. Moreover, Congress's abrogation of foreign sovereign immunity in civil actions for damages and compensation against certain designated state-sponsors of terrorism has raised fundamental questions of international law and international relations that affect US sanctions policy. The US government's rationale in allowing private remedies to be asserted through the US courts against foreign states and third country persons for alleged human rights abuses and other breaches of international law reflects a dual-track approach in its sanctions policy that relies on executive agencies to administer sanctions programmes and enforce them through administrative and judicial proceedings *and* affording private parties with legal remedies that can be pursued through the US courts against targeted foreign states, entities and individuals. The United States is the only state that has incorporated the use of private law remedies against targeted states and persons into its broader economic sanctions arsenal, which therefore merits analysis regarding its efficacy as an instrument of broader economic sanctions policy.

I The private enforcement of international law and US economic sanctions

The US has a long tradition of making private remedies available for non-US persons to assert claims against foreign persons to remedy injuries suffered in violation of US and international law. The Alien Tort Claims Act (ATCA),² was adopted in the early years of the Republic and created a private legal

¹ The Cuban Liberty and Democratic Solidarity (LIBERTAD) Act, Pub. L. No. 104–114, 110 Stat. 785 (enacted 12 Mar. 1996) codified at 22 U.S.C.A. §6021-91 (1996).

² The statute was originally included in the Judiciary Act of 1789, ch. 20, §§9, 1 Stat. 73, 76–77, codified at 28 U.S.C. §§1350 (2006).

remedy for a non-US person to bring a claim against another foreign person for committing a tort in violation of the 'law of nations'. The Act provided in relevant part that '[t]he district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States'.³ Despite this clear language, the original intent of the statute's drafters has been extensively debated and caused much controversy. In recent years, scholarly and judicial re-examination of the statute has yielded a majority view that Congress had national security foremost in mind when it enacted the ATCA. Although claims have been brought sporadically under the ATCA throughout its history,⁴ the statute was never well known as an important aspect of American jurisprudence and was widely ignored for most of US legal history. Only in the 1970s was the statute revived by Judge Irving Kaufman of the Second Circuit who transformed it into a primary tool of human rights litigation. In *Filartiga v. Pena-Irala*, Judge Kaufman, writing for the Second Circuit, held that the district court had wrongly dismissed a case in which a Paraguayan citizen had sued another for the torture and wrongful killing of her son in Paraguay. He wrote:

Construing this rarely-invoked provision, we hold that deliberate torture perpetrated under color of official authority violates universally accepted norms of international law of human rights, regardless of the nationality of the parties. Thus, whenever an alleged torturer is found and served with process by an alien within our borders, §1350 provides federal jurisdiction.⁵

Filartiga expanded the doctrine of universal jurisdiction to claims arising from acts of official torture by holding that for purposes of civil liability, the torturer has become – like the pirate and slave trader in earlier years – *hostis humani generis*, an enemy of the human race.⁶

This expansive interpretation of the ATCA's grant of authority has been adopted by the majority of US courts as granting subject matter jurisdiction and creating a private right of action.⁷ There were some courts, however, which took a narrower view of the statute's scope by holding that the ATCA's broad grant of jurisdiction did not also create a private right of action.⁸

³ *Ibid.*

⁴ Since the statute was enacted in 1790, only a few claims have been successful. See *Xuncax v. Gramajo*, 886 F. Supp. 162 (D. Mass. 1995); *Von Dardel v. U.S.S.R.*, 623 F.Supp. 246 (D.D.C. 1985); *Filartiga v. Pena Irala*, 630 F.2d 876 (2nd Cir. 1980); *Adra v. Clift*, 195 F.Supp. 857 (D. Md. 1961); *Darrell*, 3 F. Cas. 810.

⁵ 630 F.2d 876 (2nd Cir. 1980).

⁶ *Filartiga*, 630 F.2d at 890.

⁷ See *Tel Oren v. Libyan Arab Republic*, 726 F.2d at 776–781.

⁸ See Judge Bork's concurring opinion in *Tel Oren*, 726 F.2d at 801–808.

Moreover, some courts held that torts such as murder or torture committed by private actors not acting in any official governmental capacity do not constitute international torts.⁹ According to this argument, murder and torture did not rise to the level of an international tort for purposes of international human rights law unless such acts were committed by state officials or individuals acting under colour of state authority.¹⁰

The ATCA's broad scope of extra-territorial jurisdiction derives from the doctrine of universal jurisdiction, which provides that claims arising from universally condemned conduct are within the subject matter jurisdiction of all courts, regardless of the location or nationality of the parties.¹¹ The origin of the doctrine in American jurisprudence extends back to the early nineteenth century when US federal courts exercised universal jurisdiction over pirates on the high seas.¹² Similarly, at English common law, universal jurisdiction over pirates extends back to the sixteenth century (Cowles, 1945, 189). Indeed, US courts permitted civil and criminal claims to be asserted against pirates who had perpetrated acts on the high seas.¹³ Such extra-territorial jurisdiction was considered appropriate because piratical acts are by definition committed within the territorial jurisdiction of no state, and therefore the principle of extra-territoriality alone cannot protect them from assertions of national jurisdiction.¹⁴ Moreover, in the days when shipping routes were the primary means of international commerce and transportation, nations considered the threat of piracy to be a vital concern and common interest for all civilised nations. Indeed, Chief Justice John Marshall wrote in 1799 that '[a] pirate, under the law of nations, is an enemy of the human race' who '[b]eing the enemy of all, he is liable to be punished

⁹ See *Carmichael v. United Technologies Corp.*, 835 F.2d 109, 113 (5th Cir. 1988); *Sanchez-Espinosa v. Reagan*, 770 F.2d 202, 206–207 (D.C. Cir. 1985; holding that ATS does not reach tort claims arising from private conduct); *Linder v. Portocarrero*, 747 F.Supp. 1452, 1462, 1469 n.8 (S.D. Fla. 1990).

¹⁰ In *Re Estate of Marcos*, 978 F.2d 493, 499 (9th Cir. 1992); *Siderman de Blake v. Republic of Argentina*, 965 F.2d 699, 714 (9th Cir. 1992); *Forti v. Suarez-Mason*, 672 F. Supp. 1531, 1541 (N.D. Cal. 1987).

¹¹ See discussion in Chapter 3 citing Restatement (Third) of Foreign Relations Law §404 (1986).

¹² See *The Malek Adhel v. United States*, 43 U.S. (2 How.) 210, 232 (1844); (holding that 'a pirate is deemed, and properly deemed, *hostis humani generis*... [b]ecause he commits hostilities upon the subjects and property of any or all nations'; quoted in *The Chapman*, 5 F. Cas. 471, 474 (N.D. Cal. 1864)(No. 2062).

¹³ See 18 U.S.C. §1651, which states that [w]hoever, on the high seas, commits the crime of piracy as defined by the law of nations, and is afterwards brought into or found in the United States, shall be imprisoned for life.

¹⁴ *Black's Law Dictionary* p. 795 (6th ed. abridged 1991, St. Paul, West). *Black's Law Dictionary* defines piracy as '[t]hose acts of robbery and depredation upon the high seas which, if committed on land, would have amounted to a felony'. *Ibid*.

by all.¹⁵ Since the nineteenth century, US courts have expanded the category of acts recognised within the international community as susceptible to universal jurisdiction. In 1985 the Sixth Circuit Court of Appeals held that genocide is a 'universal tort' that may be vindicated by the courts of any nation.¹⁶

The increased use of the ATCA to vindicate individual rights under international law served US foreign policy objectives which had evolved in the 1970s and 1980s to include more proactive efforts to protect international political and civil rights and to redress grievances involving violations of *jus cogens* norms such as genocide and forced labour. In doing so, Congress believed it necessary to adopt legislation that extended the private remedies available under the ATCA to US nationals who had suffered torture and other grave breaches of international law. As part of its policy to promote international civil justice, Congress enacted the Torture Victim Protection Act (TVPA)¹⁷ of 1991, which created private rights of action for US nationals against state and non-state actors who had perpetrated torture and unlawful killing. The TVPA was essentially a codification of what had become accepted by most US courts that a private right of action existed for any person (US or alien) to bring a civil action for damages against an alien for committing torts that violate fundamental norms of international law. It also reflected Congress's resolve to put the protection of human rights at the core of US economic sanctions policy and to expand the scope of its enforcement to include private attorneys general who could assert individual claims against foreign perpetrators – states and non-state actors – in a way that complemented and reinforced US executive agency efforts to implement and enforce US sanctions policy. The Anti-terrorism and Effective Death Penalty Act of 1996 (AEDPA) contained provisions that amended the Foreign Sovereign Immunities Act of 1976 that substantially restricted a foreign state's sovereign immunity in US courts to allow private actions to be asserted for and damages arising from state-sponsors of terrorism.

¹⁵ The Chapman, 5 F. Cas. at 474 (quoting an oral argument by John Marshall before he became Chief Justice of the Supreme Court in the case of *United States v. Robbins*, 27 F. Cas. 825 (D.S.C. 1799). See also, Oppenheim (1955, 609) (arguing that in early state practice, a pirate was considered to be an outlaw – *hostis humani generis*).

¹⁶ *Demjanjuk v. Petrovsky*, 776 F.2d 571, 582–583 (6th Cir. 1985). In this case, Demjanjuk, a former Nazi guard at a concentration camp in Poland who had later become a naturalised US citizen, had been held by US authorities pursuant to an extradition request by Israel following an Israeli-US convention on extradition. Demjanjuk responded by filing a petition for writ of habeas corpus which was denied by the district court. The Circuit Court of Appeals upheld the denial, reasoning that the international doctrine of universal jurisdiction permitted Israel to prosecute Demjanjuk for the alleged murder of thousands of Jews during World War II.

¹⁷ Torture Victim Protection Act of 1991, Pub. L. No. 102–256, 106 Stat. 73 (1992), codified at 28 U.S.C. §1350 (Supp. V 1997).

This policy of authorising private individuals to assert claims against foreign states and persons as part of US economic sanctions was extended to include claims for confiscated Cuban property under the Cuban Liberty and Democratic Solidarity Act of 1996 (the Helms-Burton Act). The Helms-Burton Act demonstrated the important role that private remedies can play in enforcing economic sanctions. Before analysing the Helms-Burton Act, it is necessary to review the doctrinal aspects of the TVPA and the AEDPA and related issues of foreign sovereign immunity in order to understand how these remedies support US economic sanctions policy.

The Torture Victim Protection Act of 1991

The Torture Victim Protection Act of 1991 (TVPA) codifies a private right of action against foreign government officials who commit torture (official torture) and extra-judicial killing.¹⁸ The first court to hear claims under the TVPA narrowed the statute's scope of application by holding that the act was 'not intended to trump diplomatic and head-of-state immunities'.¹⁹ The court's reliance on 'head-of-state' immunity as a defence against a TVPA claim was not a reference to the statutory immunity that was codified by the US Foreign Sovereign Immunity Act; rather, it was based on the act of state doctrine, which the court interpreted as requiring a court to dismiss a claim against a foreign head-of-state (as opposed to the foreign state itself) out of deference to the role of the Executive Branch in foreign affairs.²⁰ Nearly a year after this decision, the Second Circuit reaffirmed the principle that foreign officials or private individuals acting under colour of state law could be held liable under the ATCA and TVPA and that jurisdiction could be imposed extra-territorially because of the non-commercial tort exception of the Foreign Sovereign Immunities Act. In this case, *Kadic v. Karadzic*, a lower court had ruled that acts of torture committed by Serbian troops against Muslim women were private acts that did not constitute official torture and therefore were not actionable under the ATS and TVPA. The Second Circuit reversed, finding that Karadzic and his troops satisfied the

¹⁸ Pub. L. No. 102-256, 106 Stat. 73 (1992), codified at 28 U.S.C. §1350 (Supp. V 1997). The statute provides in relevant part: 'An individual who, under actual or apparent authority, or color of law, of any foreign nations, (1) subjects an individual to torture, shall, in a civil action, be liable for damages to that individual; or (2) subjects an individual to extrajudicial killing shall, in a civil action, be liable for damages to the individual's legal representative, or to any person who may be a claimant in an action for wrongful death'.

¹⁹ *Lafontant v. Aristide*, 844 F.Supp. 128, 138 (E.D.N.Y. 1994).

²⁰ *Ibid.* at 132-133. In support of this statement, Judge Weinstein cited reports from the Senate Comm. on the Judiciary, The Torture victim Protection Act of 1991, S. Rep. No. 249, 102d Cong., 1st Sess. 7-8 (1991). This report stated that the 'TVPA [was] not intended to override traditional diplomatic immunities which prevent the exercise of jurisdiction by U.S. courts over foreign diplomats'. *Ibid.*

criteria of a state for purposes of imposing liability for those international law violations that required state action.²¹ The court also found that Karadzic had acted under ‘color of law’ insofar as he acted in concert with the former Yugoslavia, and that ‘[a] private individual acts under color of law within the meaning of [the ATS] when he acts together with state officials or with significant state aid’.²²

The Second Circuit, however, failed to address the issue of whether Karadzic should have been considered an instrumentality of a foreign state and thereby immune from suit under the Foreign Sovereign Immunity Act (FSIA).²³ The court’s avoidance of this issue is rather striking given the FSIA’s importance in this area of law. Indeed, the FSIA has played the most significant role in determining extra-territorial subject matter jurisdiction in the field of enforcing claims against states for violating norms of international law.

Foreign sovereign immunity

The Anglo-American common law has generally recognised that foreign sovereigns and their ‘agencies and instrumentalities’ have enjoyed common law immunity from civil suits. This is generally known as the doctrine of foreign sovereign immunity which was first acknowledged in US law by Chief Justice John Marshall in *The Schooner Exchange v. M’Faddon*.²⁴ The doctrine has been accepted as a principle of customary international law. Sovereign immunity is based on the notion that all nations are equals; this sovereign equality of states is necessary to maintain international stability. Accordingly, the act of subjecting one state to civil or criminal prosecution in the courts of another state violates this understanding of international order and thereby threatens the sovereignty of all states. Consequently, some have argued that states themselves should retain immunity for alleged violations of customary international law and even for breaches of fundamental *jus cogens* international norms. Another view holds, however, that a state, its agents or instrumentality which engages in conduct proscribed by international customary law should not be able to resort to international legal principles (e.g., relying on the doctrine of sovereign immunity) as a defence to the legal consequences of its conduct (Zoller 1985).

Until the mid-twentieth century, US courts consistently found sovereign immunity to be absolute out of deference to the Executive Branch, which ‘originally requested immunity in all actions against friendly foreign

²¹ *Kadic v. Karadzic*, 866 F. Supp. 734 (S.D.N.Y. 1994), rev’d sub nom. *Kadic v. Karadzic*, Civ. 94–9069 (2nd Cir. 13 Oct. 1995).

²² *Ibid.* (citing *Lugar v. Edmonson Oil Co.*, 457 U.S. 922, 937 (1982)).

²³ Foreign Sovereign Immunities Act, 28 U.S.C. §16001 *et seq.*

²⁴ 11 U.S. (7 Cranch) 116 (1812).

sovereigns'.²⁵ The State Department, however, adopted a more restrictive standard of foreign sovereign immunity in 1952 when it announced that 'immunity of the sovereign is recognized with regard to sovereign or public acts (*jure imperii*) of a state, but not with respect to private acts (*jure gestionis*).'²⁶ This restrictive standard of sovereign immunity arose primarily as a response to the rise of the state-owned trading company which was perceived as having gained an unfair advantage over its private competitors because of the shield of sovereign immunity.²⁷ The US government's adoption of the 'private acts' or 'commercial exception' to the doctrine of sovereign immunity reflected an emerging consensus amongst states that the private acts of a sovereign were not entitled to immunity. Congress codified the restrictive version of sovereign immunity in 1976 when it enacted the Foreign Sovereign Immunity Act (FSIA).²⁸ The Act generally provides sovereign immunity to foreign states and their officials, but establishes specific exceptions for acts which are private in nature.²⁹

Most of the litigation related to foreign sovereign immunity in the context of the TVPA and ATCA involves the applicability of the FSIA to individuals (Fitzpatrick, 1994, 466). In 1989 the Supreme Court in *Argentine Republic v. Amerada Hess Shipping Corp*³⁰ clarified several issues regarding the application of the FSIA to extra-territorial alien tort claims. In *Amerada Hess*, the representatives of a Liberian oil tanker which had been attacked by Argentine military aircraft during the Falklands/Malvinas war filed an

²⁵ A thorough discussion of the doctrine can be found in *Verlinden B.V. v. Central Bank of Nigeria*, 461 U.S. 480, 486–489 (1983); see also *Siderman De Blake v. Republic of Argentina*, 965 F.2d 699, 705–706 (9th Cir. 1992).

²⁶ See Acting Legal Adviser of the State Department Jack Tate's letter to the Acting Attorney General announcing the State Department's new restrictive standard. 26 Department of State Bulletin 984 (1952), reprinted in *Alfred Dunhill of London v. Republic of Cuba*, 425 U.S. 682, 711 (1976).

²⁷ Some legal scholars believed that restricting a sovereign was not only warranted for commercial reasons but should be invoked whenever a sovereign acts as a private citizen. See Lillich, R. Protection of Foreign Investment, pp. 2631 (Syracuse, New York, 1965).

²⁸ 28 U.S.C. §§1602–1613 (2006).

²⁹ Section 1605 sets forth the general exceptions to the jurisdictional immunity of a foreign state to include where (1) the foreign state waives, 'explicitly or by implication', its immunity under the Act, 28 U.S.C. §1605 (a)(1); (2) the action is based on a commercial act carried on in the United States by the foreign state, §1605 (a)(2), (3) rights in property in the United States are in issue and that property or any property exchanged for such property is present in the United States; §§1605 (a)(3) and (4) money damages are sought against a foreign state for personal injury or death, or damage to or loss of property, occurring in the United States and caused by the tortious act or omission of that foreign state (i.e., the 'noncommercial exception') §1605 (a)(5);

³⁰ 488 U.S. 428 (1989).

action for damages under the ATCA.³¹ The court held that FSIA was the 'sole basis for obtaining jurisdiction over a foreign state in our courts'.³² Moreover, the court ruled that extra-territorial tort claims – regardless of whether the underlying wrongs constituted international torts – were not within the scope of the non-commercial tort exception to sovereign immunity. Regarding the ATCA/TVPA, however, the Court ruled that the FSIA only immunises the state when it is a defendant on a ATCA or TVPA claim, but does not immunise an individual on such a claim.³³ The Court did not address the specific issue of whether individual conduct that was within the scope of official responsibility should be immunised from liability under the ATCA/TVPA.

As mentioned earlier, the Second Circuit in *Kadic v. Karadzic* ignored the issue of whether Karadzic's allegedly tortious conduct constituted a waiver of the FSIA. The opinion contains no discussion of the FSIA which might suggest that the court assumed the defendant was not a foreign sovereign despite his self-proclaimed status as President of Srpska. Since *Amerada Hess* held that the FSIA was the 'sole basis for obtaining jurisdiction over a foreign state in our courts',³⁴ and the Second Circuit made no reference to the FSIA in its determination that the trial court had subject matter jurisdiction over plaintiff's claims, it follows that the Second Circuit believed that a state official who commits or authorises acts of torture or murder in violation of the law of nations has thereby waived immunity for sovereign immunity purposes. This would be logical given the Torture Victim Protection Act's legislative history which demonstrates that Congress intended it to provide an exception to statutory and common law doctrines of foreign sovereign immunity in cases involving claims of torture committed by a foreign official 'under actual or apparent authority, or color of law, of any foreign nation'.³⁵ Indeed, it would be difficult to explain why Congress would create such broad extra-territorial subject matter jurisdiction over tort claims

³¹ *Ibid.*, at 429–30.

³² *Ibid.*, at 434.

³³ *Argentine Republic v. Amerada Hess Shipping Corp.*, 488 U.S. 428, 439 (1989).

³⁴ *Amerada Hess*, 488 U.S. at 434.

³⁵ Pub. L. No. 102–256, 106 Stat. 73 (1992) codified at 28 U.S.C. §1350 (Supp. V 1997). The legislative history of this provision is located at: H.R. Rep. No. 367, 102d Cong., 1st Sess. 3–7 (1991), reprinted in 1992 U.S.C.C.A.N. 84, 85–86; S. Rep. No. 249, 102d Cong., 1st Sess. 3–7 (1991). See also, Statement of Michael Poser of the Lawyers Committee on Human Rights before the Committee on Foreign Affairs and its Subcommittee on Human Rights and International Organizations, 100th Cong. 2d Sess. 86, 71 (1988). Poser stated that the TVPA is really an effort 'to clarify, to make sure that every federal court in the United States understands explicitly that the acts of torture and extrajudicial killing can be remedied in the United States, that there is a private right of action. And that, the U.S. Congress...has gone on record...in support of this kind of judicial relief.'

against foreign officials if such claims could be barred by the defence of foreign sovereign immunity.³⁶ This raises important questions about the scope of foreign sovereign immunity under international law and US law. Some authorities have argued that a criminal state is outside the protection of state immunity (Zoller, 1985, 158). Under the state immunity laws of most states, however, a state whose officers or agents commit an extra-judicial killing or torture as defined under international law in violation of *jus cogens* international humanitarian law has traditionally been immune from jurisdiction in a claim seeking to impose civil liability. Although Zoller argued lucidly that modern customary international law does not afford a 'criminal state' sovereign immunity protection against civil claims for compensation and damages in another state's courts for violations of *jus cogens* norms of international law, most states have recognised that, in the absence of statutory or treaty obligations to the contrary, foreign sovereign immunity is presumed.³⁷ Indeed, this is supported under both UK and US law and in most civil law jurisdictions. The US government has argued that the FSIA clearly states that the FSIA itself provides the sole and exclusive standards 'to be used by the courts in resolving questions of foreign sovereign immunity raised by foreign states'.³⁸ The rule is that jurisdiction over foreign states and their instrumentalities can only be obtained under the FSIA.

The FSIA has codified the restrictive theory of sovereign immunity which states that a foreign state is immune from the jurisdiction of the federal and state courts, except as expressly provided in the statute. If one of the enumerated exceptions to sovereign immunity applies, a US court may exercise subject matter jurisdictions,³⁹ but if the claim against the foreign state does not fall within one of the exceptions, US courts will lack jurisdiction. In the 1990s, the US government, having embarked on a war against international terrorism, adopted a comprehensive economic sanctions policy against terrorists that involved enhanced asset blocking orders, confiscations of assets and legislative remedies that would allow private individuals who had lost property and personal relations to sue foreign terrorists and foreign state-sponsors of international terrorism in US court. The authorisation of civil lawsuits against foreign state-sponsors of terrorism was done by amending the FSIA so that another enumerated exception to foreign sovereign immunity

³⁶ Such an interpretation would run contrary to the canon of statutory construction that an act of Congress should be interpreted with the assumption that its drafters had a reasonable purpose in mind, and in a way that gives effect to that purpose.

³⁷ See *Amerada Hess v. Argentina* 488 U.S. 428 (1989).

³⁸ *Ibid.* (citing the US government's *amicus* brief against holding the state of Argentina liable in damages for the torture and extra-judicial killing in *Siderman v. Republic of Argentina* (9th Cir. 1984)).

³⁹ 28 USC sec. 1330(a). See *Verlinden B.V. v. Central Bank of Nigeria* 461 U.S. 480, 497 (1983).

was created for civil lawsuits against certain designated foreign states named by the US State Department as supporting international terrorism. The legislation adopting this new policy has had a radical impact on the enforcement of US economic sanctions.

Anti-Terrorism and Effective Death Penalty Act

The Anti-terrorism and Effective Death Penalty Act of 1996 (AEDPA) among other things makes it a criminal offense for US persons to engage in financial transactions with the governments of countries designated by the Secretary of State under section 6(j) of the Export Administration Act of 1979 as a 'state sponsor of terrorism'.⁴⁰ US persons may only enter financial or commercial transactions with such targeted states by obtaining a specific license from the OFAC.⁴¹ Moreover, the AEDPA provides that a foreign state shall not be immune from the jurisdiction of the US courts 'in any case – in which money damages are sought against a foreign state for personal injury or death that was caused by an act of torture, extra-judicial killing, aircraft sabotage, [or] hostage taking[,]...except that the court shall decline to hear a claim under this paragraph – (A) if the foreign state was not designated as a state sponsor of terrorism under section 6(j) of the Export Administration Act⁴² or section 620(a) of the Foreign Assistance Act of 1961'.⁴³ This provision effectively amends the Foreign Sovereign Immunity Act by expressly creating another non-commercial exception that confirms the jurisdiction of a US court to hear and determine any civil claim for money damages arising from personal injury or death attributed to extra-judicial death or torture committed by states designated by the Secretary of State as 'terrorist' states. The Courts are therefore left with discretion to hear claims against those nations so designated as supporting terrorism.⁴⁴ The countries that have been designated as state-sponsors of terrorism since the law was enacted in 1996 include Cuba, Iran, Iraq, Libya, North Korea, Sudan and Syria.⁴⁵ The regulations that apply to designated states are known as the Terrorism List Governments Sanctions Regulations.

⁴⁰ Pub. L. 104–132, 110 Stat. 1214–1319 (1996), codified at 18 U.S.C. §2339B (1997). See also, Foreign Terrorist Organizations Sanctions Regulations 31 C.F.R. §597.201.

⁴¹ The governments of targeted states are listed in section 6(j) of the Export Administration Act of 1979, codified at 50 U.S.C. §6(j) app. 2405 (1996). The application for these licenses will only be approved in the most extenuating circumstances.

⁴² *Ibid.*, at §2405(j).

⁴³ 22 U.S.C. §2371 (1997).

⁴⁴ This assertion is supported in *Rein v. Socialist People's Libyan Arab Jamahiriya*, 995 F.Supp 325, 327–328 (E.D.N.Y. 1998).

⁴⁵ In 2003, Iraq was removed from the list, while Libya was removed in 2005, but pending lawsuits remain against both states for actions that were commenced when they were designated state-sponsors of terrorism.

The AEDPA abrogation of sovereign immunity for certain foreign states that sponsor or support international terrorism can possibly be justified on legal and policy grounds as a countermeasure under international law. As discussed in Chapter 3, the countermeasure involves a dispensation from an international obligation. This could occur when a state imposes prescriptive jurisdiction on a foreign state for supporting a terrorist act outside the sanctioning state's territory but which would attract universal jurisdiction because the terrorist act itself was a violation *jus cogens* norms. Extending the FSIA exceptions to include civil damage remedies against certain designated foreign states who breach peremptory norms of international law can serve as a type of reprisal against the foreign state that is involved in extrajudicial killing or torture. These private remedies may also take on a penal function, as plaintiffs may recover in certain circumstances punitive damages against designated foreign states if they are able to show that the state engaged in egregious conduct that merit civil penalties. Indeed, punitive damages are an extraordinary remedy for a private party to assert against a foreign state, and would ordinarily be precluded on sovereign immunity grounds. The US Congress, however, adopted the so-called Flatow Amendment in 1998 that amends the FSIA to allow US nationals to recover punitive damages from designated state-sponsors of terrorism if these states caused, facilitated or contributed to extra-territorial terrorist acts that cause losses for US nationals.⁴⁶

The elimination of the sovereign immunity defence for acts of torture and extra-judicial killing reaffirms the rights of private victims under US law to bring civil actions for compensation and damages before US courts against certain nations which have breached fundamental norms of international law. For example, it would allow an individual who has been tortured in the territory of a foreign state to seek damages in US courts from that foreign state if it had supported or sponsored such acts. As a result of the legislation, many lawsuits have been filed against foreign states designated by the State Department as state-sponsors of terrorism and more significantly against foreign business enterprises and financial institutions allegedly involved in facilitating transactions supporting terrorists or aiding and abetting terrorism.

For example, in *John P. O' Neill, Jr. et al. v. Al Baraka Investment and Development Corporation et al.*, a class action was certified in the US federal court for the Southern District of New York composed of the families of individuals who died in the terrorist attacks on the Twin Towers in New York City, the Pentagon, and in Pennsylvania on 11 September 2001.⁴⁷ The plaintiffs alleged that the named defendants which are foreign banks,

⁴⁶ See *Flatow v. The Islamic Republic of Iran*, 999 F. Supp. 1 (US Dist. DC., 1998).

⁴⁷ *The Estate of John P. O'Neill, Sr., on behalf of John P. O'Neill, Sr., et al., v. Al Baraka Investment and Development Corporation a/k/a Al Baraka Bank, a/k/a DallaH Al Baraka Group, LLC et al.*, in the United States District Court for the Southern District of

businesses and Islamic charities and cultural organizations had provided commercial, financial and logistical support to the hijackers of the four planes that crashed into the Twin Towers, the Pentagon, and Pennsylvania respectively and thereby were knowingly concerned in committing torts (e.g., wrongful death) in violation of the law of nations (Alien Tort Claims Act) and other offences under the Torture Victims Protection Act (TVPA) and AEDPA. Although the defendants had allegedly provided commercial, financial and logistical support to the nineteen hijackers outside the US, the provisions of the ATCA and TVPA create extra-territorial prescriptive jurisdiction over them because of their knowing support of international terrorism in violation of AEDPA and their breach of *jus cogens* international norms. Several of the defendant banks are partially owned by the government of Sudan, but will not benefit from the FSIA because AEDPA has expanded the exception to foreign sovereign immunity to include civil damages claims against designated foreign states that allegedly support terrorism.

The significant number of claims that have been brought under the TVPA and ATCA has demonstrated its importance in promoting the US foreign policy objective of combating international human rights abuses and terrorism. The ATCA, TVPA and AEDPA play important roles in allowing tort victims access to US courts, thereby fulfilling the US government's statutory obligation to provide a forum for the international enforcement of human rights law in which legal remedies or sanctions may be imposed against those state instrumentalities and their officials who violate important principles of international law. The private right of action created in these laws is an important element in the enforcement of US economic sanctions. The legal theory supporting these statutory causes of action derives from the doctrine of universal jurisdiction. Although immunity defences may protect a state against suit in certain situations, the doctrine of universal jurisdiction promotes international justice by allowing states to create the means by which individuals may vindicate universally recognised international rights against foreign states and their officials in limited circumstances. Universal jurisdiction may be seen as a theory of international law that respects the sovereign equality of states but also allows the extra-territorial application of law to promote important rights and principles of civil justice. As will be seen in the next section, the US Congress has not only created private rights of action that can result in damages and punitive sanctions against those who abuse human rights and commit international terrorism, but also can lead to damages and restitution against foreign persons who benefit from the commercial use of confiscated Cuban property.

New York. See *Khulumani v. Barclay Nat. Bank Ltd.* WL 2985101 (2nd Cir., 2007) (upholding cause of action for third party liability of companies for allegedly violating *jus cogens* norms and discussion of relevant principles).

II The Cuban Liberty and Democratic Solidarity Act⁴⁸

The Cuban Liberty and Democratic Solidarity Act, better known as the Helms-Burton Act,⁴⁹ contains a number of important provisions which purport to increase pressure on the Castro regime by tightening the forty-six year-old US trade embargo against Cuba. Title III of the Act contains sweeping language which permits US nationals whose property was expropriated without compensation by the Castro regime to sue foreigners in US federal court if they benefit from the use of such confiscated property.⁵⁰ Title IV of the Act requires the revocation of travel visas issued by the US government to any foreign person who is the officer, director or controlling shareholder of a business entity which does business affecting expropriated property in Cuba.⁵¹ These provisions have already angered US trading partners and have prompted some to enact retaliatory measures against US exporters.⁵² Moreover, the Act codifies the existing Cuban trade embargo, which has imposed sanctions through executive orders since 1962,⁵³ and increases direct and indirect economic sanctions against Cuba. The primary purpose of the law is to deter third country foreign investment in Cuba so that US property claims will not be prejudiced by the growing amount of foreign investment in expropriated Cuban property.⁵⁴ Most significantly, in regard to enforcing US economic

⁴⁸ On 12 March 1996, President Clinton signed into law the Cuban Liberty and Democratic Solidarity (LIBERTAD) Act. Cuban Liberty and Democratic Solidarity Act, Pub. L. 104–114, 110 Stat. 785 (codified at 22 U.S.C. §§6021–6091 (1995)).

⁴⁹ The Helms-Burton Act was named after former Senator Jesse Helms of North Carolina and former House Representative Dan Burton of Indiana.

⁵⁰ Section 302(a), Title III, codified at 22 U.S.C. §6082 (1996).

⁵¹ Section 401(a), Title IV (Grounds for Exclusion), codified at 22 U.S.C. §6091(a) (1996). The revocation of visas under Title IV also applies to the family members of the officials of companies which have benefited from the use of expropriated property. 22 U.S.C. §6091 (a)(4).

⁵² Then Mexican President Ernesto Zedillo's assertion that Helms-Burton Act violates the North American Free Trade Agreement. The *Economist*, 8 June 1996, p. 45. The Organisation of American States (OAS) voted 23 to 1 to pass a resolution condemning Helms-Burton Act as violative of sovereignty. *Ibid.*

⁵³ The Embargo on All Trade with Cuba was first imposed on 3 February 1962 by President Kennedy. Proclamation 3447, 3 Feb. 1962, Fed. Reg. 1085 (1962). The initial embargo and implementing regulations were issued pursuant to §620(a) of the 1961 Foreign Assistance Act, Pub. L. No. 87–195, §620(a), codified at 22 U.S.C. §2370(a) (presently (a)(1)). 22 U.S.C. §6032(h), which derives its authority from 22 U.S.C. §1631(e), International Claims Settlement Act of 1949 (authorising the president to impose trade sanctions by executive order).

⁵⁴ Section 102(h) in Title I codifies all existing laws and regulations imposing an embargo on Cuba. The codification of all the embargo legislation, executive orders and regulations means that Congressional approval will be required before the embargo can be modified or re-interpreted. Before Helms-Burton, the president was authorised 'to establish and maintain a total embargo on all trade between the United States and

sanctions, the Helms-Burton Act creates a private right of action for US nationals to bring civil suits against any foreign nationals who allegedly traffick in confiscated Cuban property.⁵⁵ By authorising US nationals to pursue their confiscated property claims in US court, Congress has sought to circumvent the diplomatic impasse between Cuba and the US Executive Branch and to bring more direct pressure on Cuba to settle the property claims of former US owners and to bring about democratic reforms.

The legislation is premised on the proposition that the international legal system has failed to provide US nationals whose property was confiscated by the Cuban government with an effective remedy for their Cuban property claims.⁵⁶ Although customary international law requires a state to pay compensation for property which it has expropriated from a foreign investor, the Cuban government has failed to provide any compensation for US-owned property that was confiscated by the Castro regime, thereby failing to fulfil its obligations under international law.⁵⁷ The Helms-Burton Act further broadens the jurisdictional scope of US economic sanctions by imposing

Cuba'. This authority was an effective diplomatic tool for presidents to use when they needed to adjust economic sanctions against certain countries as part of the overall framework of US foreign policy. Since the late 1960s, US presidents have on occasion modified sanctions against Cuba according to the needs of US diplomacy. Title I of the Act removes that discretion. This section is likely to have a dramatic impact on the way in which the US reacts to events on the island, for it imposes considerable restrictions on the president's ability to take executive action with respect to Cuba.

⁵⁵ This section applies to 'confiscated property' in Cuba which, on the date of enactment of the Act, was subject to 'a claim owned by a United States national'. Section 4(4) defines 'confiscated' to include:

the nationalization, expropriation, or other seizure by the Cuban Government of ownership or control of the property, on or after January 1, 1959-(i) without the property having been returned or adequate and effective compensation provided; or (ii) without the claim to the property having been settled pursuant to an international claims settlement agreement or other mutually accepted settlement procedure.

Section 4(4), Title I, codified at 22 U.S.C. §6043 (a).

⁵⁶ Section 4(12) defines property as 'any property (including patents, copyrights, trademarks, and any other form of intellectual property), whether real, personal, or mixed, and any present, future, or contingent right, security, or other interest therein, including any leasehold interest'. s. 4 (15), Title I, codified at 22 U.S.C. §6048(a)(15).

⁵⁷ The US government has responded by maintaining a trade embargo against Cuba since 1963 for the primary purposes of pressuring the Castro regime to provide full market compensation to expropriated US investors and to adopt political and economic reforms within Cuba. During most of the Cold war, Cuba received substantial amounts of direct aid from the Soviet Union which it used to mitigate the harshest aspects of the US economic embargo. There was a dramatic reduction, however, in Russian economic aid for Cuba after the Soviet Union collapsed in 1991 with the result that the combined effect of the US embargo and reduced Russian aid imposed new constraints on the Cuban economy which led the government to adopt a limited privatisation programme designed to lure private foreign investment into the Cuban

civil liability and US visa restrictions on any third country national (US-controlled or not) who deals in confiscated Cuban property. The Helms–Burton Act also imposes civil liability against all non-US banks or lending institutions that finance transactions involving confiscated Cuban property. Furthermore, the Helms–Burton Act creates a private right of action for US nationals to bring civil lawsuits in US courts against third country nationals for trafficking in confiscated property. The use of a private right of action to enforce US economic sanctions raises a number of important policy issues regarding the efficacy of sanctions enforcement by private parties and whether these so-called ‘private attorneys general’ should be authorised to enforce a state’s economic sanctions policy.⁵⁸

The civil liability provisions of Title III of the Act create powerful remedies by imposing money damages against any person who trafficks or derives any benefit from the use of expropriated property.⁵⁹ Title III creates a private right of action against ‘persons’ who ‘traffic’ in property that was once owned by US nationals or entities but was expropriated without compensation by the Cuban government after the 1959 revolution.⁶⁰ Title III also imposes civil liability on any lending institution (US or foreign) which finances any type of business activity between non-US persons and the Cuban government

economy and in particular to use that investment to develop confiscated property that was once owned by US nationals (Perez-Lopez, 1994, 191–195).

⁵⁸ The four major provisions of the Act have the stated purposes of: (1) increasing international sanctions against the present Cuban government; (2) assisting Cuba in the transition to a democratically elected government; (3) protecting the property rights of US nationals who had Cuban property expropriated by the Castro government after the 1959 revolution; and (4) excluding from US territory aliens who have confiscated property of US nationals in Cuba or who traffic in such confiscated property. Section(s) 102, 103, 302 and 401 of the Act, codified at 22 U.S.C. §6022.

⁵⁹ Section 302(a), Title III, codified at 22 U.S.C. §6082(a) (1996).

⁶⁰ Section(s) 301, 302, 303, Title III, codified at 22 U.S.C. §§6082, 6083, 6084, & 6085 (1996). U.S. nationals include US companies, individual US citizens, and political asylum refugees from Cuba who later became naturalised citizens of the US. In addition, Section 4(13) defines ‘traffic’ as:

(A) A person traffics in confiscated property if that person knowingly and intentionally

- (i) Sells, transfers, distributes, dispenses, brokers, manages, or otherwise disposes of confiscated property, or purchases, leases, receives, possesses, obtains control of, manages, uses, or otherwise acquires or holds an interest in confiscated property,
- (ii) Engages in commercial activity using or otherwise benefiting from confiscated property, or
- (iii) Causes, directs, participates in, or profits from, trafficking (as described in clause(s) (i) or (ii)) by another person, or otherwise engages in trafficking (as described in clauses (i) or (ii)) through another person, without the authorization of any United States national who holds a claim to the property.

Section 4(13), Title I, codified at 22 U.S.C. §6023 (1996).

which affects expropriated property.⁶¹ Moreover, Title III explicitly rejects the Act of State Doctrine and empowers US courts to adjudicate the property claims arising from the Cuban government's expropriations of property located within Cuban territory which occurred after 1st January 1959.⁶²

In addition, Title IV of the Act imposes broad immigration exclusions from US territory against aliens who have confiscated the Cuban property of US nationals or have trafficked in or derived economic benefit from such property.⁶³ The provision is broad in the sense that it defines excludable aliens to include not only the individuals responsible for the property taking but also anyone who directed or supervised a confiscation or trafficked or benefited from using confiscated property. This provision applies to corporate officers and controlling shareholders of companies that have been 'involved' in the expropriation or trafficking of such property.⁶⁴

The primary purpose of the Helms-Burton law is to increase pressure on third country nationals to stop investing in Cuba and to reduce or eliminate their holdings of expropriated Cuban assets. By exposing third country nationals to liability, the Act essentially permits US claimants to enforce

⁶¹ Section 103 (a), Title I, *codified at* 22 U.S.C. §6082 (a)(4)(A). Section 103(a) prohibits any 'U.S. national, permanent resident alien, or U.S. agency' from knowingly extending any 'loan, credit, or other financing' to any person for the purpose of 'financing transactions involving any confiscated property the claim to which is owned by a U.S. national as of the date of enactment of this Act'. *Ibid.*

⁶² Section 302(a)(6), Title III, *codified at* 22 U.S.C. §6082(a)(6). Section 302(a)(6) provides that 'no court of the United States shall decline, based upon the act of state doctrine, to make a determination on the merits in an action brought under paragraph (1)'. *Ibid.*

⁶³ Section 401(a), Title IV, 22 U.S.C. §6091(a) (1996).

⁶⁴ This provision allows the government to use US immigration law as an instrument of economic sanctions to put pressure on foreign nationals to comply with US sanctions objectives by denying them access to the US for pleasure or business. For example, in July of 1996, the State Department sent advisory letters to the senior executives of three non-US companies that their US travel visas would be revoked if they did not sever their ties with their respective company within forty-five days. Marcus (1996b) reports that three companies received advisory letters from the US State Department warning the companies senior executives that they might be denied entry into the US because their companies were in violation of the Helms-Burton Act). The three companies were the Sherritt International (Sherritt), a Canadian mining company, STET, an Italian telecommunications company, and Grupo Domos, a Mexican conglomerate. (The *Economist*, Biter Bitten, 1996, 45. Perhaps the most publicised of the three companies is Sherritt, a Toronto-based mining that operates a Cuban nickel mine in a joint venture with the Cuban government (Fineberg, 1996, 2). Until 1959, the Cuban nickel operations were owned and operated by subsidiaries of Freeport Sulfur Co., a company based in New Orleans and known as Freeport-McMoran Inc., the copper, gold, and sulfur producer, and by National Lead Co., which has since changed its name. *Ibid.* As of January of 1998, the State Department has denied visas to the executives of Sherritt, Grupo Domos and STET (Sanger, 1997, A7).

their property rights under international law by authorising US courts to hear their claims. Although Helms–Burton has become US law, the president has the authority to suspend or waive the filing of private claims under Title III for six-month intervals if the president determines that to do so is in the US national interest.⁶⁵ The Act requires the president to make this determination every six months beginning in July of 1996.⁶⁶ The first of these waivers went into effect on 16 July 1996, when President Clinton suspended authorisation for filing actions, and the waivers have been renewed every six months since 1996 throughout both the Clinton and Bush administrations, presumably to avoid the rash of court filings and countermeasures by foreign countries and in an effort to pressure US trading partners not to do business with Cuba until the US and Cuba can resolve the property claims.

Liability for trafficking in expropriated assets

Section 103 (a)⁶⁷ imposes both criminal and civil penalties against any US bank or lending institution which knowingly finances a transaction involving confiscated Cuban property. The provision essentially expands the Cuban trade embargo to cover any US lending institution which provides loans or credits for transactions involving confiscated property to which a US national has a claim. The Act, however, does not define what constitutes a ‘claim’ or what it means to ‘own’ such a claim. Because of this lack of definition, lending institutions to which §103(a) may apply will need to develop means for determining whether any property in Cuba that might in the future be involved in one of their lending transactions was subject, on the date of enactment of the Act, to an expropriation claim by a US national. If the property at issue is included in one of the expropriation claims certified by the Foreign Claims Settlement Commission (FCSC) under the Cuban Claims Programme,⁶⁸ the determination by the lending institution

⁶⁵ Presidential authority to suspend the private right of action under Title III derives from sections 306(b) and 306(c)(1)(b) of Title III, which provides that:

the President may suspend the right to bring an action under this title with respect to confiscated property for a period of not more than 6 months if the President determines and reports in writing to the appropriate congressional committees at least 15 days before suspension takes effect and that such suspension is necessary to the national interests of the United States and will expedite a transition to democracy in Cuba.

22 U.S.C. §6063(c)(1)(B).

⁶⁶ See also 22 U.S.C. §6064(a).

⁶⁷ Section 103(a) of Title I of the Act prohibits any ‘United States national, a permanent resident alien, or a United States agency’ from knowingly extending any ‘loan, credit, or other financing’ to any person for the purpose of ‘financing transactions involving any confiscated property the claim to which is owned by a United States national as of the date of enactment of this Act’. Section 103(a), Title I, 22 U.S.C. §6048 (1996).

⁶⁸ See The Cuban Claims Act of 1964, 78 Stat. 1110 (codified at 22 U.S.C. §1643 *et seq.* (Supp. V 1994). Pursuant to Title V of the International Claims Settlement Act of 1949,

is relatively straightforward. However, there are potentially hundreds of thousands of individuals who were not US nationals when their properties were seized by the Cuban government and who therefore failed to qualify to have their claims certified by the FCSC under the Cuban Claims Programme; the programme only permits claims certification to those who were US nationals at the time their properties were expropriated.⁶⁹ These uncertified claimants have never had the opportunity to assert their claims in a public forum and their identity is not generally known. If those individuals are deemed to 'own claims' to these properties as of the date of enactment of the Act, then any property in Cuba could be subject to an undisclosed expropriation claim by a US national. The potential liability for lending institutions which finance transactions which are either directly or indirectly related to the use of expropriated property is enormous.

The Office of Foreign Assets Control is enforcing section 103(a) and has issued notices to all US banks and their foreign branches that their loans and transactions since March of 1996 may subject them to criminal and civil liability under the Cuban Assets Control Regulations.⁷⁰ These financial institutions are advised to exercise extreme caution in order not to knowingly handle or process any loans or credits to persons doing business with expropriated property in Cuba.⁷¹ These banks and finance companies must not engage in any trade, either direct or indirect, with Cuba.⁷² Any bank or finance company which violates these provisions is at risk for substantial monetary fines and possible criminal prosecution. In addition, US lending institutions are prohibited from 'knowingly' extending credit for transactions involving expropriated property in Cuba to which a US national owns a claim.⁷³ The requisite degree of knowledge is not defined in the statute, but could come directly from the claimant or through official notice from US government agencies. The notice can also probably be imputed to the lender if, through the exercise of reasonable diligence, it could have ascertained the existence of an expropriation claim against the property.

In addition to the outright prohibition against US financial institutions doing business in Cuba, Title III of the Act imposes civil liability on any

Congress authorised the International Claims Commission (ICC) to adjudicate and administer certain expropriation claims held by US entities. 78 Stat. 1110–1111, 22 U.S.C. §1643b(b). The ICC was renamed in 1954, becoming the Foreign Claims Settlement Commission (FCSC). In 1964, Congress authorised the FCSC to administer and adjudicate against the Cuban government expropriation claims. 22 U.S.C. §1643c(a).

⁶⁹ *Ibid.*

⁷⁰ See *The Cuban Trade Embargo and the Financial Community*, The Office of Foreign Assets Control (Jan. 1998).

⁷¹ *Foreign Assets Control Regulations For The Financial Community*, The Office of Foreign Assets Control (Dept. Treasury 1998) p. 4.

⁷² See Title 31 Part 515 of the Code of Federal Regulations (1997).

⁷³ 22 U.S.C. §6091(b)(1)(A).

person who benefits from the commercial use of confiscated Cuban property. Taken together with section 103, this provision may reasonably be interpreted as imposing liability on any bank or lending institution which knowingly provides financing of any sort to any person who is using the loan or credit to do business in a manner which affects expropriated property. The language of this provision is so broad that it will impose liability on US or non-US banks which make loans to any person who directly or indirectly derives an economic benefit from the use of expropriated properties. For example, if a UK bank makes a loan to a French tobacco wholesaler which then purchases tobacco from an expropriated Cuban farm and then sells the tobacco in China and uses the proceeds to payoff the loan, the bank would qualify as trafficker and risk being sued by the former landowners – a US national – even though none of the tobacco was sold in the United States. Similarly, if a non-US bank provides a credit or finances any transaction involving confiscated Cuban property, it can be subject to a lawsuit under Title III of the Act by a US national holding claim to such confiscated property. Some non-US banks and financial institutions have already been placed on notice by prospective claimants under Title III and by the State Department that they are deriving proceeds from loans to foreign nationals whose business activities benefit from expropriated Cuban property. The officers, directors and shareholders of financial institutions are therefore exposed to potential civil liability under Title III of the Act for allegedly trafficking in confiscated Cuban property.

Trafficking in confiscated Cuban property

The Act defines ‘trafficker’ as any alien (company or individual) who benefits from the use of Cuban property confiscated after the 1959 Cuban revolution.⁷⁴ The definition of trafficking in expropriated property includes ‘the buying and selling’ of expropriated property and ‘engag[ing] in commercial activity using or otherwise benefitting from confiscated property’.⁷⁵ This sweeping provision would subject any foreign company to a lawsuit in US court if that company had direct or indirect business dealings affecting expropriated property in Cuba. For instance, if a French company purchased sugar from an Italian wholesaler who, in turn, had purchased the sugar from a Cuban plantation which had been expropriated and the French company processed the sugar into a product which it sold for a profit, such a sale would constitute commercial activity which benefits from expropriated property. The French company, therefore, could be held liable for damages in US court, even though it had purchased the sugar from a non-Cuban and had made no sales of the sugar product into the United States.

⁷⁴ §105, Title I, codified at 22 U.S.C. §6023 (4)(B)(i).

⁷⁵ Title III, §302(a), codified at 22 U.S.C. §6082(a).

Claimant eligibility

Title III of the Act establishes a private right of action for any US national to file a claim in US federal courts against any person who ‘traffics’ in expropriated property. The Act defines US national not only as a person who was a US citizen at the time their property was expropriated, but also as a person who became a US citizen after the expropriation occurred.⁷⁶ The Act divides the universe of eligible US nationals who are entitled to file civil rights of action into three categories. First, there are the individuals and entities whose claims were certified by the Foreign Claims Settlement Commission (FCSC) under the Cuban Claims programme. Second, there are the US nationals who were not eligible to file claims under the Cuban Claims programme. Third, there are the individuals and entities who were eligible to file claims under the Cuban Claims programme but failed to do so, or who had filed claims but had them denied by the FCSC. Each will be addressed separately below.

The following discussion assumes that there is property in Cuba that is defined under §4(4) of the Act as ‘confiscated property’, and that the activities of the third country national would fall under the very broad definition of ‘trafficking’ in such property. Section 4(13) of the Act states that a person ‘traffics’ in confiscated property if that person knowingly and intentionally

1. sells, transfers, distributes, dispenses, brokers, manages or otherwise disposes of confiscated property, or purchases, leases, receives, possesses, obtains control of, manages, uses, or otherwise acquires or holds an interest in confiscated property,
2. engages in a commercial activity using or otherwise benefiting from confiscated property, or
3. causes, directs, participates in, or profits from, trafficking (as described in clause 1 or 2 by another person, or otherwise engages in trafficking (as described in clause 1 or 2 through another person)⁷⁷

without the authorisation of any US national who holds a claim to the property. The definition excludes residential property unless it is subject to a claim certified by the FCSC or is occupied by an official of the Cuban government or ruling party. The Act exempts from the definition of trafficking, *inter alia*, the trading or holding of securities which are publicly traded or

⁷⁶ A US national, according to Section 4(15), is ‘any United States citizen’, or ‘any other legal entity which is organized under the laws of the United States, or of any State, the District of Columbia, or any commonwealth, territory, or possession of the United States, and which has its principal place of business in the United States’. 22 U.S.C. §6023 (15) (1996).

⁷⁷ 22 U.S.C. §6045.

held unless the activity is by or with a Cuban person or entity on the Office of Foreign Assets Control's Specially Designated Nationals List.⁷⁸

As mentioned earlier, the number of eligible claimants includes not only certified claimants under the FCSC programme, but also any US national 'who acquires ownership of the claim before' the date of enactment of the Act. Therefore, if a certified claimant has assigned its ownership of a claim to a third party before the enactment of the Act, the third party has the right to bring an action in place of the certified claimant.⁷⁹ Moreover, nothing in the Act prohibits a group of non-US nationals who have no connection whatsoever with the United States but who have claims for expropriated property in Cuba from forming a US corporation and assigning their claims to that corporation to be asserted in a Title III action.⁸⁰

Certified claimants

The Act authorises certified claimant to sue and obtain a judgment against a third country national trafficking in confiscated property in Cuba. A certified claimant has the right, under §302(a) of the Act, to bring a civil action for damages in a US federal court against 'any person' who after the end of a three-month grace period beginning on the effective date of Title III of the Act,⁸¹ 'traffics in property that was confiscated by the Cuban government on or after 1 January 1959' to which the plaintiff has a certified claim.

There are several time periods, however, that constrain this right of action. First, Title III was initially intended to become effective on 1 August 1996.⁸² Second, the statute provides a three-month waiting period after Title III becomes effective in which no liability attaches to conduct that would otherwise be considered 'trafficking'. The president has authority to suspend the effective date for filing lawsuits under Title III for discrete six-month periods if the president 'determines and reports in writing to the appropriate congressional committees at least fifteen days before such effective date that the suspension is necessary to the national interests of the United States and will expedite a transition to democracy in Cuba'.⁸³ The president may keep the suspension in effect for consecutive periods of six months,⁸⁴ or

⁷⁸ 31 Code of Federal Regulations §515.560(b) & (c) (1995)[hereinafter 31 C.F.R. §515.560 (b)].

⁷⁹ 22 U.S.C. §6040–6041. The third party claimant must be a US national.

⁸⁰ In fact, some US lawyers in Florida have formed such a corporation on behalf of Spanish claimants who still hold unresolved property claims against the Cuban government.

⁸¹ s. 4(13), Title I, codified at 22 U.S.C. §6023(13)(B)(i).

⁸² s.306(a), Title III, codified at 22 U.S.C. §6082(a).

⁸³ s. 306 (b)(1), codified at 22 U.S.C. §6063(b)(1).

⁸⁴ *Ibid.*, at 22 U.S.C. §6085 (b)(1) & (2).

may reimpose the suspension after Title III has become effective.⁸⁵ The suspension of claims expires automatically at the end of each six-month period, unless the president renews the suspension not less than fifteen days before the expiration of the previous period. During any period in which the filing of claims is permitted under Title III, the president may immediately reimpose the suspension as to claims not yet filed and impose a stay as to claims which are pending in court.⁸⁶ Moreover, at any time, the president may rescind any suspension of the applicability of Title III by 'reporting to the appropriate committees that to do so will expedite a transition to democracy in Cuba'.⁸⁷ The Act therefore provides the president with significant discretion to suspend indefinitely the filing of any claims against third country persons allegedly benefiting from the use of confiscated Cuban property.

Beginning in July 1996, President Clinton and President Bush have exercised this authority to suspend the right to file claims under Title III against parties which are allegedly trafficking in expropriated property.⁸⁸ The initial effect of the suspension was to impose a 'cooling off' period in which foreign nationals were given the opportunity to limit their liability under the law by disposing of expropriated assets. Presidents Clinton and Bush each continuously issued these 'waivers' every six months in order to delay the filing of Title III actions. This has resulted in an indefinite delay in the filing of these actions which suggests that US presidents have used the threat of allowing these actions to proceed as a signalling device to third country states which have been trading and investing with Cuba to reduce their commercial involvement with confiscated property claimed by US nationals. The benefit of this 'light-handed' approach by the US government is that it allows negotiations to continue between the US and its trading partners over the best approach to bring about political and economic reform in Cuba.

The president's suspension of claims under Title III has had the effect of postponing the time at which claims may be brought by the period in which the presidential suspension is in effect. Despite the repeated renewals of the six-month suspension period, foreign parties are still at risk because the president may revoke the suspension period at any time without notice; and once the suspension period has expired or has been revoked there is no grace period for the foreign defendant to prepare against any potential claims.

⁸⁵ U.S.C. §306(b)(2).

⁸⁶ §306(c), Title III, codified at 22 U.S.C. §6063(c).

⁸⁷ *Ibid.*

⁸⁸ *Glen v. Club Mediterranee, S.A.*, 450 F.3d 1251, 1255 (11th Cir., 2006).

Damages

Under Title III of the Act, persons who traffick in expropriated property will be liable for money damages to any US national who holds a claim to such property.⁸⁹ The amount of liability imposed would be based on the value of the expropriated property and not on the value of the property from which the defendant benefited or used.⁹⁰ With respect to the defendant, this is the most onerous section of Title III. Thus, if a UK company purchased ten thousand US dollars of tobacco from a confiscated Cuban farm which had been valued at one million US dollars, the company would be liable not for the value of the tobacco sold into the US but for the value of the confiscated farm – one million dollars. There is no connection whatsoever between the amount of liability imposed and the economic benefit derived from the trafficking activity. Moreover, after being placed on notice that it is trafficking in confiscated property, if the alleged trafficker refuses to settle with the claimant and then is determined to be liable, the defendant's liability could reach three times the value of the expropriated property plus attorney's fees, interest and costs.⁹¹

Once a lawsuit has been filed under Title III, the certified claimant can recover from the defendant up to three times the greater of (1) the amount certified to the claimant by the FCSC plus interest, or (2) the fair market value of the confiscated property. Under the statute, the fair market value of the property can be calculated as either the current value of the property, or the value of the property when confiscated, plus interest.⁹² The claimant can also recover 'court costs and attorneys fees'.⁹³ In determining the value of expropriated property for purposes of recovery, there will be a presumption in favour of the amount certified by the FCSC; such a presumption can be rebutted by 'clear and convincing evidence' that the fair market value is the appropriate amount of liability.⁹⁴

Claims' limitations

An important limitation on the ability of claimants to file suit is a two-year statute of limitations. Under Title III, actions may not be brought more than two years after the trafficking giving rise to the action ceased. For the person who has been dealing in or benefiting from expropriated property, this is significant because when they cease dealing in such property, a two-year period begins to run beyond which no Title III lawsuit

⁸⁹ Title III, §302 (a)(3), codified at 22 U.S.C. §6082(a)(3).

⁹⁰ *Id.*

⁹¹ Title III, §302 (a)(1), codified at 22 U.S.C. §6082(a)(1).

⁹² 22 U.S.C. §306(c).

⁹³ 22 U.S.C. §6082 (a)(1).

⁹⁴ 22 U.S.C. §6082 (a)(2).

may be brought with respect to that property. This statute of limitations period may begin to run while the presidential suspension is in effect. The suspension period becomes, therefore, a window of opportunity in which the trafficker may not be sued for benefiting from confiscated property but has the opportunity to dispose of such property and thereafter to eliminate its Title III liability after the two-year limitations period has expired.

Subject to these limitations, the Act imposes strict liability on third parties deemed to be trafficking in confiscated properties in Cuba.⁹⁵ Assuming that federal jurisdiction can be asserted over the third party defendant, the plaintiff needs to establish two elements in order to prove liability: (1) that the defendant was 'trafficking' in the properties at issue after plaintiff's right of action accrued under the statute, and (2) that the last act of 'trafficking' occurred two years or less before the initiation of the action. With regard to damages, the plaintiff can recover costs, attorneys' fees, and three times either the certified amount of the claim or the fair market value of the property, if that can be established.⁹⁶

Parties who fail to get their claims certified

The statute explicitly limits the ability of two types of potential claimants to bring civil suits under Title III: first, US nationals who were eligible to file a claim with the FCSC under the Cuban Claims Programme but failed to do so. Second, US nationals who filed a claim with the FCSC but had their claim denied. The first type of claimant is barred altogether from bringing an action under Title III. The second type of claimant is not precluded from bringing a court action against a third country national, but the court must accept the findings of the Commission on the claim as conclusive in the action under this section.⁹⁷ Presumably, this second type of claimant can bring an action but would have to submit additional evidence beyond that determined by the FCSC to be sufficient to prove ownership of the property in question or the amount of the loss sustained.

Newly identified claimants

The Act allows US nationals who were not eligible to file an expropriation claim with the FCSC under the Cuban Claims Programme to bring an action for damages against third country nationals who are allegedly trafficking in confiscated Cuban properties. Such actions, however, would be subject to

⁹⁵ Ibid.

⁹⁶ 22 U.S.C. §6082(a)(5)(B).

⁹⁷ Ibid.

the conditions and limitations discussed above for certified claimants, and the following limitations:

1. The action may not be filed 'before the end of the two-year period beginning on the date of enactment of this Act'.⁹⁸ This period would replace the three-month wait period applicable to certified claimants, and would be independent of any suspensions in the effective date of Title III imposed by the president. Because the presidential suspension has remained in effect since July 1996, whenever it is lifted non-certified claimants will have the right to sue immediately any third country national who has trafficked in confiscated Cuban property within the preceding two years. For example, if the president lifts the suspension on 1st January, 2009, any conduct constituting trafficking on that date will permit the alleged trafficker to be sued immediately or, within a two-year period thereafter.
2. In an action by a non-certified US claimant, the plaintiff would have to establish ownership of the property in question and the amount of the claim. The Act allows the court to appoint a master, 'including the Foreign Claims Settlement Commission', to make determinations regarding the amount and ownership of the claim.⁹⁹
3. A non-certified US claimant is not entitled to recover treble damages from a third country defendant unless it gives notice of its claim to the foreign national allegedly trafficking in the property at issue.¹⁰⁰ If the party so notified continues to traffick thirty days after receiving the notice, then the US claimant can recover treble damages in its action against the foreign party. Because the effective date of Title III of the Act was 1st August, 1996, the period of time in which a non-certified US claimant could give notice to a potential defendant was on or after 1st November, 1996; and thirty days after receiving such notice (i.e., as early as 1st December, 1996) the foreign party could become liable to the claimant for treble damages if it were still trafficking in the property in question at the time the lawsuit is filed, although, as noted above, a lawsuit could not be instituted until the time when the president lifts the suspension. At this point, though, the thirty day period must still lapse before a non-certified claimant may file the lawsuit.

The possibility of recovering treble damages should be strong incentive for a potential non-certified claimant to reveal itself early in the process, and if

⁹⁸ Title III, §302 (a)(5)(C), codified at 22 U.S.C. §6082(a)(5)(C).

⁹⁹ Title III §303 (a)(2), codified at 22 U.S.C. §6083(a)(2). Such determinations would not constitute certifications for purposes of the Cuban Claims Programme.

¹⁰⁰ §302 (a)(3)(B), Title III, codified at 22 U.S.C. §6082(a)(3)(B).

the defendant continues to traffick in the claimed property on or after the time the president lifts the suspension, the claimant may recover treble damages. The thirty-day period would not begin to run if the claimant puts the defendant on notice before the suspension period has ended. It is also important for the non-certified claimant to put the defendant on notice because such notice serves to satisfy the requirement that the foreign party engage in the activities constituting trafficking 'knowingly and intentionally'.¹⁰¹ In the absence of such disclosure, it would be difficult for the plaintiff to establish that the foreign party had knowledge of the existence of a claim.

Conclusion

The purpose of this chapter was to show how the design of economic sanctions measures can include the private enforcement of legal rights to achieve broader sanctions policy objectives. The use of private legal remedies in court to enforce international legal and domestic legal rights is a growing weapon in the US economic sanctions arsenal. The use of the private rights of action under the Alien Tort Claims Act (ATCA) and the Torture Victims Protection Act (TVPA) provide US and foreign nationals with the legal remedy to assert civil liability claims against foreign officials and individuals acting as agents of the state or under colour of state authority in order to recover compensation, damages, restitution and/or declaratory relief. In addition, under Anti-terrorism and Effective Death Penalty Act of 1996, private parties may recover civil damages against certain foreign states designated by the US State Department as state-sponsors of terrorism. Moreover, Title III of the Helms-Burton Act provides a private right of action for any US person with a certified claim from the US government to sue any person anywhere in the world who is benefiting from confiscated Cuban property. Although these lawsuits have not yet been allowed to proceed because of presidential waiver authority, they remain a liability risk for many foreign businesses and individuals doing business in Cuba. The combined use of traditional state sanctions measures and private rights of action has the effect of putting more pressure on sanctions targets and sharing the enforcement costs with private parties. These alternative approaches, however, are not without their risks, as by authorising private parties, the sanctioning state can possibly lose control over the time and place sanctions can be applied. The waiver authority of the president in the Helms-Burton Act, however, shows how some of these problems can be mitigated. Nevertheless, although the US legislation may have deterred a significant amount of

¹⁰¹ §302 (a)(2)(B), Title III, codified at 22 U.S.C. §6082(a)(2)(B).

foreign investment in Cuba and foreign bank support for states designated by the US government as state-sponsors of terrorism, these laws have also caused much concern amongst US trading partners and has prompted some of them to enact retaliatory measures. These so-called blocking laws will be discussed in the next chapter.

8

Blocking Statutes, Foreign Illegality and Extra-Territorial Economic Sanctions

We cannot remain inactive when this Sword of Damocles hangs over European companies and individuals.

EU Trade Commissioner Sir Leon Brittan (1997)

Introduction

The increased scope and rigour of US sanctions in recent years have produced a strong reaction by many countries and regional trading blocs against their unilateral and extra-territorial application. Emblematic of this backlash has been the reaction in the international community to the Cuban trade embargo, the Helms-Burton Act and the Iran Sanctions Act. Most countries contend that these sanctions laws violate international law (Marcus, 1996b, 9). Canada and Mexico have claimed that the Cuban trade embargo and Helms-Burton Act violate US obligations under the NAFTA.¹ Both countries have taken domestic legislative action to counter the Act. The Canadian Parliament responded by amending existing blocking laws to make it illegal for Canadian businesses, including Canadian subsidiaries of US companies, to comply with the provisions of the Act.² In addition, the Canadian Parliament has amended its Foreign Extraterritorial Measures Act to provide Canadian companies a means to countersue in Canadian courts to recover damages awarded against them by US courts under Title III

¹ U.S.-Can.-Mex., 32 *ILM*. 289, final draft revision 6 Sept. 1992, entered into force, 1 Jan. 1995.

² The *Economist*, 7 Sept. 1996 at 40. The EU Council of Ministers responded by warning that the EU will freeze US assets and impose visa requirements on US executives and their families in mirror image to the Helms-Burton Act, if the United States attempts to penalise companies in any of its member nations. *Ibid*.

of the Helms-Burton Act.³ In 1996, Mexico's Senate unanimously approved a Helms-Burton 'antidote' law which fines Mexican companies that allow themselves to be fined under Helms-Burton.⁴ Moreover, in 1996, the Juridical Committee of the Organisation of American States (OAS) adopted a unanimously approved statement condemning the Helms-Burton Act and the Cuban Democracy Act as contrary to international law.⁵

Similarly, since the 1980s, the British Government has taken measures to oppose the extra-territorial application of US economic sanctions by adopting statutory orders pursuant to the British Protection of Trading Interests Act 1980 that purport to block the extra-territorial effects of the Cuban trade embargo.⁶ Moreover, the Council of Ministers of the European Union (EU) adopted a Regulation which is intended to neutralise the impact of the Helms-Burton law and any other extra-territorial economic sanctions that apply to the trading activities of EU nationals. In addition, the United Nations General Assembly has adopted resolutions that condemn the imposition of US sanctions in cases where restrictions are imposed against third country trade with US-targeted states. In the late 1990s, the European Union, Japan, and Canada invoked the dispute resolution mechanisms of the World Trade Organisation Treaty to allege that the extra-territorial application of US economic sanctions against third country trade with US-targeted states violates the WTO Agreement.⁷ This chapter analyses the legal and regulatory framework that has been adopted by other major states and regional trading blocs to counteract the extra-territorial application of US sanctions.

I National responses to extra-territorial US sanctions

The UK's response to US extra-territorial sanctions

The Government of the United Kingdom has been at the forefront of attempts to restrict the extra-territorial reach of export controls and economic sanctions of foreign states – most notably those of the United States.

³ John Urquhart, *Wall St. J.* 14 Mar. 1997, at A4, A18. See also, *New York Times* 14 Mar. 1996, at A7. See also Wilner (1993).

⁴ See Reuters, North American Wire, 19 Sept. 1996.

⁵ *Latin Am. Wkly Rep.*, Resistance Grows To Helms-Burton Law, pp. 413 (12 Sept. 12; reporting the OAS Juridical Committee's ruling that Helms-Burton and Democracy Act violates international law).

⁶ As discussed below, these Orders provide certain UK nationals and business entities with a private right of action to recover damages and penalties incurred as a result of the enforcement of US sanctions. See *infra* notes 8–11 and accompanying text.

⁷ 'U.S. To Ignore Panel on Cuba Dispute: Standoff with European Union May Weaken World Trade Organization' *Dallas Morning News*, (21 Feb. 1997), at 10D, available in 1997 Westlaw 2648369.

Indeed, the British government took direct action to restrict and neutralise the extra-territorial application of US law – in particular, US anti-trust and export control laws – when it enacted the Protection of Trading Interests Act 1980.⁸ The Protection of Trading Interests Act represented a significant shift in policy by the British Government in combating extra-territorial claims of foreign states. The Government's stated intent in enacting the measure was to 'reassert and reinforce the defences of the United Kingdom against attempts by other countries to enforce their economic and commercial policies'.⁹ To accomplish this objective, the Act authorises the Secretary of State to impose a combination of three different measures to combat the extra-territorial claims of foreign states. First, it increases the British Government's power to forbid compliance by UK nationals and businesses with the orders of foreign governments, where those orders are determined to have extra-territorial effect and to prejudice British trading interests. Second, it prohibits United Kingdom courts from enforcing foreign judgments or orders that award multiple damages and certain other judgments that implicate the control of restrictive practices. Third, it creates a right of action in United Kingdom courts on behalf of UK nationals or businesses against whom foreign courts have awarded multiple damages to recover the non-compensatory portion of damages from overseas plaintiffs.¹⁰ The Act has been considered an important legal and diplomatic response to the extra-territorial application of US anti-trust law and economic sanctions.

UK state practice

As discussed earlier in this study, the British and US governments have had serious disagreements over the extra-territorial application of national economic regulation throughout the twentieth century. During both World War I and World War II, the British Government imposed extra-territorial economic sanctions against third country persons who were trading with enemy countries¹¹. Outside of these wars, the UK adhered to more traditional

⁸ Protection of Trading Interests Act 1980, (1980 c 11) (Cracknell's Statutes, 1996, 245–252).

⁹ 973 Parl. Deb. HC (1979) p. 1533.

¹⁰ Section 6(a)–(c). This provision allows a UK person to institute a civil action to recover non-compensatory damages from both private plaintiffs and government agencies which have brought enforcement actions against the UK person based on the extra-territorial application of their laws. The right to recover such damages against a foreign government agency raises important issues of sovereign immunity. Under section 2(3) of the UK State Immunity Act 1978 (c 33), a UK person may bring an action in UK court against a foreign state if the state had instituted proceedings against the UK person in a related dispute.

¹¹ For specific analysis of extra-territorial application of British Trading With The Enemy Acts during World War I and World War II, see W.F. Trotter, *Law of Contract Before and During War* (2nd edn; 1942) 28–41, apps. A-D (containing statutory

principles of territorial jurisdiction in applying its economic and commercial regulation. During the last half of the twentieth century, the UK government was steadfast in its opposition to the extra-territorial claims of foreign states that seek to regulate, in any manner, subject matter or persons that are subject to the jurisdiction of United Kingdom courts.¹² Moreover, it has expressly stated that it considers the 'effects doctrine' to be a violation of the jurisdictional principles of international law.¹³ After 11 September 2001, the UK adopted terrorist financing legislation based on EU directives and regulations that applies expressly to the extra-territorial conduct of designated terrorists and terrorists organisations and to the third parties who support them or facilitate their transactions.

The Protection of Trading Interests Act 1980

The UK government's concern for extra-territorial US economic legislation applied specifically to anti-trust law and export controls in the late 1970s and early 1980s. In particular, when Congress was debating proposed amendments to the EAA in 1977, the British Government expressed its concerns to the US State Department in a Diplomatic Note dated 25 August 1977 in which it stated:

Her Majesty's Government express once again their concern at the scope of recent amendments to the Export Administration Act, in particular those provisions which attempt to control actions by United States-controlled companies operating in other countries. As the Embassy informed the Administration during the consideration of these amendments by Congress, these particular provisions would represent an extension of United States claims of jurisdiction and would accordingly constitute an invasion of the jurisdiction of the United Kingdom (Lowe, 1983, 147–148).

descriptions of 1914 and 1915 Orders in Council for British Trading With The Enemy Act and 1939 Statutory Orders for Trading With The Enemy Act).

¹² When a US grand jury, while investigating the foreign petroleum industry for alleged acts in violation of anti-trust laws, issued a subpoena demanding certain foreign oil companies, including the Anglo-Iranian Oil Company, to produce documents that were not located in the US, the British Government issued an order to the Anglo-Iranian Oil Company not to comply with the request because the Government considered it 'contrary to international comity' to compel the non-US officers of a non-US company to produce documents that were not in the US, nor related to the company's US business activity (Mann, 1963, 1462). The British Government stated in its aide-memoire that 'the United Kingdom Government have for their part consistently objected to the assumption of extraterritorial jurisdiction in antitrust matters by the courts or authorities of a foreign state when that jurisdiction is based upon what is termed the "effects doctrine"'. 698 Parl. Deb. HC (1964) p. 1280.

¹³ See Diplomatic Note (No. 196), British Embassy in Washington DC (27 July 1978), reprinted in 49 *BYBIL* 390 (1979).

In response, the US and British governments conducted further negotiations in an attempt to mitigate the extra-territorial effect of the EAA. After these negotiations failed to produce a settlement, Congress enacted in 1979 substantial revisions to the EAA which, *inter alia*, significantly expanded the extra-territorial scope of export controls to prohibit the use of certain US technologies and products by third country nationals without a validated licence issued by the Department of Commerce. Further, US export controls would apply to companies incorporated in third countries on the basis that a US shareholding (not necessarily a majority shareholding) exerted a controlling interest in a non-US company that was selling products, intellectual property or was involved in some other type of commercial activity with targeted states or entities. Export controls would also apply to the re-export of goods from one overseas country to another, if those goods were originally manufactured in the USA, or contained components or materials originating in the USA, or were made with the use of data or technology of US origin. Moreover, export controls would become retroactive, thus frustrating the performance of contracts already entered into in good faith between US and third country parties in conformity with applicable law at the date of the contract's execution.¹⁴

In 1980, when Parliament began considering new legislation that would more effectively protect British trading interests against the extra-territorial laws of foreign nations, it was clear that such legislation was primarily a response to the extra-territorial effect of US anti-trust and export control laws that were viewed by the British Government as infringements upon British trading interests and sovereignty. When the Bill proposing the Act was under consideration, the Secretary of State for Trade stated:

My objective in introducing this Bill is to reassert and reinforce the defences of the United Kingdom against attempts by other countries to enforce their economic and commercial policies unilaterally on us...the most objectionable method by which this is done is by the extraterritorial application of domestic law. In theory this is a general problem since many countries have policies which, given the occasion and the inclination, they might seek to enforce on persons located, or engaged in activities, beyond the normal bounds of national jurisdiction as recognised in international law. In effect, however, the practices to which successive

¹⁴ See 15 C.F.R. §746.1)-(8)(1998)(1979 amendments that increased extra-territorial controls of US-origin exports of technology and component parts). The 1979 Amendments reflected Congress's intent to broaden the purpose of export controls to include not only specific national security objectives (e.g., controlling the spread of military and dual-use technology to communist states), but also other foreign policy goals, such as protecting human rights (Lowenfeld, 1983, 54–69).

United Kingdom Governments have taken exception have arisen in the case of the United States of America.¹⁵

The Act was therefore intended to block the application of extra-territorial and unilateral US economic and commercial laws.

The Act authorises the Secretary of State for Trade and Industry to make a determination that any measure taken under the law of a foreign country to control or regulate international trade which has an effect on persons or property outside the territorial jurisdiction of that country and which damages or threatens UK trading interests may be subject to a direct order that prohibits the measure from being applied in the UK.¹⁶ The Act provides the Secretary with discretion to impose blocking orders either generally against a particular foreign law or a specific transaction. Section 1(2) authorises the Secretary to order that UK businesses be required to provide notice to the Department for Business Enterprise and Regulatory Reform of any such requirement imposed by foreign legislation and to prohibit UK businesses from complying with such legislation.¹⁷ Further, the Secretary 'may give to any person in the United Kingdom who carries on business there such directions for prohibiting compliance with any such requirement or prohibition as aforesaid as he considers appropriate for avoiding damage to the trading interests of the United Kingdom.'¹⁸ The exercise of such powers by the Secretary is subject to parliamentary control; no UK person is entitled to invoke the Government's protection under the Act.¹⁹

The powers delegated to the Secretary of State are broad, as they apply to any foreign measures that seek to control international trade-including any type of business. The Act would cover, for example, regulations or orders adopted by foreign regulatory agencies or adjudicative tribunals. Significantly, the Secretary of State has discretion to impose blocking orders if the foreign measure in question merely has an effect on international trade and damages

¹⁵ [1979] 50 *BYBIL* 357.

¹⁶ Section 1(1) of the Act states that if the Secretary of State for the Department of Trade and Industry (DTI) determines:

- (a) that measures have been or are proposed to be taken by or under the law of any overseas country for regulating or controlling international trade; and
- (b) that those measures, insofar as they apply or would apply to things done or to be done outside the territorial jurisdiction of that country by persons carrying on business in the United Kingdom, are damaging or threaten to damage the trading interests of the United Kingdom, that the Secretary may by order direct that this section apply to those measures either generally or in their application to such cases as may be specified in the order.

¹⁷ Secretary may order that he be notified by the person concerned of 'any requirement or prohibition imposed or threatened to be imposed' pursuant to such measures upon any person carrying on business in Britain. *Ibid.*, s. 1(1).

¹⁸ *Ibid.*, s. 1(3).

¹⁹ s. 1(2).

or threatens to damage UK trading interests. It is not necessary for the Secretary to make a finding that the foreign measure in question infringes UK territorial jurisdiction.

Under this standard, the Government could disregard a technical violation of UK territorial jurisdiction that did not prejudice British trading interests. Foreign measures, however, that do prejudice such interests would be subject to an order under the Act without the necessity of demonstrating that they infringe UK jurisdiction. The Government therefore may take action in cases to block a foreign measure that may be wholly lawful under international law, but which prejudices British trading interests. The primary purpose of the Act is not to allocate regulatory control over international trade according to refined principles of jurisdiction, but instead to protect the commercial activities of persons conducting trade in Britain by ensuring that their trading practices are regulated only by, or with the approval of, the British Government.

Under section 2 of the Act, the Secretary of State may direct persons within the United Kingdom not to comply with actual or imminent demands of foreign courts, tribunals or government agencies to produce commercial documents or information located outside the territorial jurisdiction of the issuing state in any one of the following four cases: (1) where the foreign requirement 'infringes the jurisdiction of the United Kingdom or is otherwise prejudicial to the sovereignty of the United Kingdom'; (2) if compliance with the foreign requirement threatens the security of the United Kingdom or prejudices its relations with any other state; (3) if the foreign order has been issued in a proceeding that is other than a civil or criminal proceeding in a foreign country; or (4) if it requires the UK person to produce documents or records relevant to such proceedings that are in its possession, custody or power, but which have not been specified or identified with particularity in the foreign order.²⁰ Based on these factors, the Minister's powers are not constrained by the criterion that the foreign requirement infringe UK jurisdiction. A blocking order may issue if the foreign demand or request is 'prejudicial to the sovereignty of the United Kingdom', or if it is 'prejudicial to the security' or interferes in the 'relations of the... United Kingdom' with any foreign government.²¹ The reference to 'sovereignty' and 'security' was intended to give the Government broader authority to impose blocking orders in cases where foreign demands for documents or other evidence did not necessarily impinge British trading interests in the direct way that a

²⁰ ss. 2(1)–(6). Moreover, section 4 supplements section 2 by providing that UK courts should not make orders under the Evidence (Proceedings in Other Jurisdictions) Act, 1975, where the Secretary of State certifies that a request for evidence by a foreign tribunal 'infringes the jurisdiction of the United Kingdom or is otherwise prejudicial to the sovereignty of the United Kingdom'.

²¹ *Ibid.*, s. 2(2)(a).

substantive foreign regulation would but where such evidentiary requests would infringe sovereignty or national security. The US government criticised this provision because it would allow the British Government to prohibit a US national in Britain from complying with a US court order to produce evidence located *either* in Britain or in a third country.²² The UK Government countered these criticisms by issuing a diplomatic note that pointed out that since the Secretary of State had discretionary powers to issue such orders, he could be expected to take into account 'all the aspects of any case including the extent of U.K. and other interests and considerations of international comity.'²³

In addition to these discretionary blocking powers in sections 1 and 2, section 5 imposes an absolute obligation on UK courts not to enforce foreign judgments awarded for multiple damages or designated 'competition judgments,' or those on a claim for contribution in respect of a judgment in either of the former categories. Section 5(4) authorises the Secretary of State, subject to parliamentary control, to designate 'competition judgments' or other foreign orders that appear to prohibit or regulate certain agreements, arrangements or practices designed to restrain, distort or restrict competition in the carrying on of business of any description or to be otherwise concerned with the promotion of such competition.²⁴ The issue of whether to block foreign judgments or orders will depend not on whether the foreign court has jurisdiction, but on whether enforcement of such orders would infringe British trading interests or sovereignty.

The authorisation to impose such blocking orders reflects the broader English public policy that prevented the enforcement at common law and later at statute of a foreign judgment for multiple damages.²⁵ The statutory obligation in section 5 was seen as a codification of existing English law that recognised the so-called revenue rule whereby a court in one state does not accept the obligation to enforce the public law remedies of another state (Dicey and Morris, 1993, 97–108)²⁶ According to the revenue rule, multiple

²² US Diplomatic Note No. 56 (9 Nov. 1979) pp. 23 (a copy obtained from UK Department of Trade and Industry).

²³ Diplomatic Note No. 225 (27 Nov. 1979). The UK note also stated that although a blocking order could be enforced regarding any person's conduct in Britain, it could not be an offence for a non-UK person residing in Britain to comply with a US court order to provide documents located outside the UK. The Act s. 3(2).

²⁴ *Ibid.*, s. 5(4).

²⁵ See Foreign Judgment (Reciprocal Enforcement) Act 1933, s. 4(1)(a)(v); *Re Macartney* [1921] 1 Ch. 522.

²⁶ The revenue rule derives from Lord Mansfield's ruling in *Holman v. Johnson* that no action could lie in an English court for the enforcement of a foreign revenue law. (1775) 1 Cowp. 341, p. 343. Today, unless there is a treaty to the contrary, an English court will not enforce three types of foreign laws: revenue, penal and other public

damage awards (including punitive damages) were considered penal in nature, and therefore unenforceable (Stone, 1996, 336–337; Cheshire and North, 1999, 447–448).²⁷ Similarly, regarding the compensatory element of multiple damage awards, the UK government's position was that, given the impact of US private treble damage actions on international trade, there was no provision in UK law permitting the recovery of such judgments in UK courts. This means that the unmultiplied element of damages awarded, representing the actual loss found by the foreign court to have been sustained, may not be enforced in an English court.

Another important provision in the Act is section 6, which permits a UK citizen, company or person carrying on business in the UK to recover or claw-back multiple damage awards obtained against them by a foreign individual, entity or state.²⁸ These persons become 'qualifying defendants' under the terms of the section if they have paid voluntarily or through execution²⁹ an amount on account of a multiple damage award, either to the successful party in the foreign action or to another party entitled to a contribution from the qualifying defendant.³⁰ Sections 3 and 4 provide two exceptions to the UK persons right to countersue: (1) where the 'qualifying defendant' was either an individual who was 'ordinarily resident' in the state where the proceedings were instituted and the judgment issued, or if a company, had its principal place of business in such state;³¹ and (2) where the 'qualifying defendant' carried on business in the overseas country 'and the proceedings in which the judgment was given were concerned with activities exclusively carried on in that country.'³² Subject to these exceptions, the qualifying defendant may recover the non-compensatory portion of any amount paid by it to a party in whose favour the original judgment or order was made.

The US government strongly objected to section 6 because it would allow a non-UK company doing business in both the UK and US, but having its

laws (Cheshire & North 1999, 107). This three-pronged classification of public laws has also been adopted by Australian, New Zealand and Irish courts (Ibid.). See also 973 Parl. Deb., H.C. (5th ser.) 1546 & 1548 (1979) (recognising 'the principle whereby sovereign states do not accept an obligation to enforce the public economic policies of other sovereign states').

²⁷ 973 Parl. Deb., HC (1979) pp. 1548, 1566.

²⁸ s. 6 (1). Companies eligible to make claims include those incorporated 'in a territory outside the United Kingdom for whose international relations' the British Government is responsible are also included together with those entities incorporated in the United Kingdom. s. 6(1)(b).

²⁹ s. 6(6).

³⁰ s. 6(1). The section allows recovery for judgments or orders issued after the Act. s. 6(8).

³¹ s. 6(3).

³² s. 6(4).

principal place of business in a third country, to utilise a UK court to reverse any order for damages plus costs issued by a US court. Section 5 recognises, however, that where there is a subsidiary, or business entity, that operates primarily in the US, with no operations anywhere else, the non-US parent or owner will not be allowed to recover damages under the claw-back provision, even if the subordinate or subsidiary company has its place of incorporation in the UK.³³ Moreover, a UK court may hear a claim under this section even if the person against whom the proceedings are brought is not within the territorial jurisdiction of the court.³⁴ It is also important to emphasise that the qualifying defendant need not prove that the foreign law or measure infringed UK jurisdiction. Equally significant, the right of a 'qualifying defendant' to recover damages on a countersuit in a UK court may not be qualified or superseded by the discretionary order of a Minister. The UK Government's position was based on the policy of not only blocking the extra-territorial application of both US economic sanctions and anti-trust laws, but also deterring – through the claw-back provision – private persons as well as the US government from instituting proceedings in US court to impose damages and penalties upon UK persons for undertaking activities that were entirely legal under the laws of the United Kingdom.

Protection of Trading Interests Act and the Siberian pipeline dispute

The first application of the Act to US extra-territorial sanctions controls was made during the Siberian pipeline dispute in 1982 when Lord Cockburn, the then-Secretary of State, issued an Order that applied section 1 of the Act to certain US export control regulations.³⁵

The designated US regulations had specifically imposed US jurisdiction over the re-export from third countries of goods either originating in the United States or containing parts manufactured in the United States, or goods manufactured by US-controlled companies, or manufactured with the use of US technology. These regulations forbade British companies which had already entered into contracts to supply parts and technology for use on the pipeline from fulfilling their contractual obligations that arose before the implementation of the US sanctions.

³³ Parl. Deb. HC, Standing Committee F, Protection of Trading Interests Act Bill, Second Sitting p. 74.

³⁴ s. 6(5). This ironically enough results in the English court asserting extra-territorial jurisdiction over persons not within the territorial jurisdiction of the UK.

³⁵ Specifically the designated US measures were those provisions of parts 374, 376, 379, 385, and 399 of the Export Administration Regulations, as amended, made by the United States Secretary of Commerce under the powers conferred on him by the United States Export Administration Act 1979 which affect the re-export or export of goods from the United Kingdom. See S.O. 1982 (SI 1982/885).

The Order was issued pursuant to powers under section 1(1) of the Act after negotiations between the British and US governments failed to resolve the dispute surrounding the extra-territorial application of US export controls to UK persons who were conducting business on the Siberian pipeline.³⁶ The decision to impose the Order was based on facts that showed that the US export control regulations were damaging UK trading interests. Moreover, based on these findings, the Secretary of State, relying on his powers under section 1(3), issued directions to certain British companies ‘forbidding them to comply’ with the US embargo on the re-export of products and technology to third countries for use in the Soviet pipeline.³⁷ This discretionary authority, however, to designate some UK companies and persons, and not others, not to comply with extra-territorial US export controls was alleged to have resulted in differential treatment between UK firms. As a result, some UK firms petitioned the English High Court requesting a judicial review of the Secretary of State’s decision not to designate them. In one case, a UK company, Cemi Limited, which had not been designated for protection under the Order, petitioned the Queen’s Bench Division for judicial review on the grounds that the Secretary of State had abused his discretion in refusing to make a further order under the Act so as to designate it as a protected entity from US sanctions. The High Court, however, rejected the petition and upheld the Secretary’s refusal to afford the protections of the Act to some British businesses.³⁸

The case of *Cemi Limited* demonstrated the lack of uniformity in the application of the Act to British entities that were affected by the extra-territorial application of US economic sanctions. Indeed, the case affirmed the Secretary of State’s broad discretion to decide which UK nationals and firms could be protected from complying with extra-territorial foreign measures. In fact, since the High Court’s ruling in *Cemi Limited*, the British Government has rarely issued orders to protect British businesses from the extra-territorial scope of US sanctions, despite numerous enforcement proceedings and

³⁶ (1982) 53 *BYIL* 452–453. On 2 August 1982, Lord Cockburn made the following statement in the House of Lords:

On 30th June I made an Order under section 1(1) of the Protection of Trading Interests Act 1980 citing certain provisions of the Export Administration Regulations which were damaging to the trading interests of the United Kingdom.

I had hoped ... that it would have been possible for an acceptable solution to be found to this problem; but, despite strenuous efforts made by her Majesty’s Government, the American administration has not so far responded.

Ibid.

³⁷ See (1982) 53 *BYIL* 452–453. The Order issued by Lord Cockburn directed the following British companies not to comply with the US export controls: John Brown Engineering Ltd., Smith International (North Sea) Ltd., Baker Oil Tools (U.K.) Ltd., and AAF Ltd.

³⁸ *Re Cemi Limited* CO/1542/87 (18 Feb. 1988).

blocking orders imposed by the US government against UK-owned or controlled companies and banks that were involved in commercial transactions with US-targeted states. In the Soviet pipeline dispute, the UK Government issued orders prohibiting some UK companies from complying with extra-territorial US export controls, but many UK companies were not protected by the Act and were exposed to liability under US sanctions (Mabry and Moyer, 1985, 117–128). Moreover, in response to the US government's freeze in the 1980s of Libyan assets that were held by US-controlled banks operating in the UK, the British government issued no orders requiring non-compliance with such extra-territorial US blocking orders. One can only surmise that the political repercussions of challenging the US on this issue would have been too costly for British foreign policy, and the Government was quite content to allow the legal claims that arose from these blocking orders to be resolved by the English courts. The UK government did not formally confront the US government again with respect to extra-territorial US sanctions until 1992 when it ordered UK firms not to comply with the extra-territorial provisions of the Cuban economic embargo.

Protection of Trading Interests Act and Cuban embargo

Before Congress enacted the Cuban Democracy Act of 1992, the US Treasury Office of Foreign Assets Control had leniently approved general licences to do business with Cuba for UK and other foreign companies which were owned or controlled by US companies or individuals so long as no US citizen or company was involved. The Cuban Democracy Act, however, expressly prohibited the US Treasury from approving any such licences. After the Act was adopted, the UK and US governments failed to reach agreement to mitigate the extra-territorial impact of the Cuban Assets Control Regulations which implemented the Cuban embargo. The UK government then reaffirmed its opposition to such extra-territorial restrictions by adopting a general order under the Protection of Trading Interests Act that all UK companies and persons who were doing business with Cuba outside the US in violation of the Cuban economic embargo were not to comply with the 1992 Act and the embargo's regulations.³⁹ The UK Secretary of State issued the order on 19 October 1995 that stated 'no person or persons in the United Kingdom shall comply, or cause or permit compliance, whether by themselves, their officers or agents with any requirement or prohibition imposed on them pursuant to [Cuban Assets Control Regulations] in so far as such requirement or prohibition affects trading activities carried on in the United Kingdom or the import of goods to or

³⁹ S.I. (14 October 1992), Order No. 2449 (1992)(US Cuban Assets Control Regulations). The Order was adopted a few days before President Bush signed the Cuban Democracy Act on 23 October 1992. Before its enactment, the proposed CDA was strongly criticised by the European Commission and the UK Government.

the export of goods from the United Kingdom'.⁴⁰ The definition of 'Trading activities' included 'any activity carried on in the course of a business of any description'.⁴¹ The language of the order suggests that it was aimed specifically at the Cuban trading activities of UK companies (i.e., 'persons') which were owned or controlled by US parent corporations. The UK government's willingness to impose orders directly challenging the extra-territorial application of US economic sanctions put it on a collision course with US foreign policy with respect to the breadth and scope of US sanctions policy towards Cuba. Further, the UK order created compliance challenges for UK firms and individuals based in the UK who were trying to do business with both the US and Cuba.

Canada's response to US extra-territorial sanctions

Another country with strong commercial relations with the US is Canada. Notwithstanding the high degree of interdependence and market integration between Canada and the United States, one of the most significant issues on which both governments have agreed to disagree concerns the extra-territorial application of US economic sanctions, especially with respect to how such sanctions are applied to Cuba. Canada is one of Cuba's largest sources of investment.⁴² Consequently, the United States actions with respect to Cuba have a direct impact on the relationships between Canadian and Cuban governments as well as between the Canadian and the United States governments and on companies and investors operating in each country.

The 1985 Foreign Extraterritorial Measures Act

The Canadian Parliament enacted the Foreign Extraterritorial Measures Act (FEMA)⁴³ in 1985 to defend Canadian interest from attempts by foreign governments or courts to impose unreasonable laws or rulings in Canada through extra-territorial jurisdiction. FEMA authorises the Canadian Attorney-General to forbid compliance in Canada with extra-territorial measures by any state which the Attorney-General has determined to infringe on Canadian sovereignty. There is also protection against the disclosure of documentation or evidence from foreign decision-making

⁴⁰ Ibid.

⁴¹ Ibid.

⁴² Ibid. Canada, Mexico and Spain have the largest amounts of investment and trade with Cuba. Canada's economic relationship is valued at approximately \$575 million (Cdn\$) of total trade per year. Department of Foreign Affairs and International Trade. *Cuba Fact Sheet*, May 1997.

⁴³ Foreign Extraterritorial Measures Act (FEMA), R.S.C., ch. F-29 (1985), as amended, 9 Oct. 1996, 1996 S.C., ch. 28, reprinted in 36 ILM 111 (1997).

bodies if such disclosure would infringe on the sovereignty of Canada.⁴⁴ It was under FEMA that the Parliament enacted in 1992 a blocking order to prevent the application of the Cuban Democracy Act in Canada.

Before the Cuban Democracy Act, however, there had been no orders issued to block the application of US economic sanctions. This was because the Cuban Assets Control Regulations (CACRs) readily allowed the Canadian subsidiaries of US companies to obtain a licence to trade with Cuba.⁴⁵ US authorities generally granted the licences on the condition that components originating in the US were strictly limited, and that no US technical information was passed to Cuba. In addition, strategic exports were prohibited, and the foreign subsidiary was required to be independent in its dealings with Cuba.⁴⁶ Since these terms affected only those companies over which the United States could claim jurisdiction through control of the parent company, foreign countries did not suffer significant economic consequences, as the subsidiaries were generally permitted to continue their operations under the licensing scheme. Consequently, the CACRs did not really apply extra-territorially and did not create much diplomatic controversy.

US policy took a different course though in 1992 when the *Cuban Democracy Act* (CDA) was enacted.⁴⁷ As mentioned above, the CDA repealed the licensing scheme created under the CACRs which had allowed US-controlled foreign companies to trade with Cuba. The CDA required OFAC to enforce the the CACRs against US-controlled foreign subsidiaries that conducted business with Cuba in foreign states. These companies were no longer permitted to export goods to Cuba, regardless of whether or not the goods contained US-origin components. Naturally, this had an effect on the economies of the foreign countries in which the subsidiaries were located. Canada responded quickly to protect companies against the effects

⁴⁴ Section 3 (1) of the FEMA provides as follows:

'Where, in the opinion of the Attorney-General of Canada, a foreign tribunal has exercised, is exercising or is proposing or likely to exercise jurisdiction or authority of a kind or in a matter that has adversely affected or is likely to adversely affect significant Canadian interests in relation to international trade or commerce involving a business carried on in whole or in part in Canada or that otherwise has infringed or is likely to infringe Canadian sovereignty, or jurisdiction or powers that is or are related to the enforcement of a foreign trade law or a provision of a foreign trade law set out in the schedule, the Attorney-General of Canada may, by order, prohibit or restrict the [production of records or giving of evidence].

⁴⁵ Between 1975 and 1992, both the Office of Foreign Assets Control and Department of Commerce had approved applications for such licences on a regular basis because the US government's policy was not to apply the CACRs to the trading activities of US-controlled foreign companies outside the United States.

⁴⁶ Canadian Embassy in Cuba, *Cuba: A Guide for Canadian Business*, (1997) 51–52.

⁴⁷ Pub. L . 102–84, 106 Stat. 2581 (23 Oct. 1992) codified at, 22 U.S.C. §60 01 *et seq.*

of the CDA. The Canadian government created a 'Blocking Order'⁴⁸ under the authority of the FEMA,⁴⁹ which prohibited compliance with the CDA by Canadian companies. The basic purpose of the 1992 Blocking Order was to prohibit compliance by US-controlled Canadian companies with the extra-territorial controls that were imposed by the CACRs because of the revocation of the US licensing scheme. US-controlled Canadian companies were required to continue trading with Cuba as if nothing had changed. The 1992 Blocking Order also imposed an obligation on Canadian companies to report any communications relating to the CDA to the Attorney-General, particularly if those communications had the effect of altering trade between the Canadian business and Cuba. To ensure compliance with the 1992 Blocking Order, monetary penalties were provided for in the event of breaches of the Order.

The 1992 Blocking Order had the effect of creating a direct conflict between Canada and the US over the application of the US embargo to the Canadian trading activities with Cuba of US-controlled Canadian companies. As a legal matter, the Blocking Order neutralised the extra-territorial application of the US embargo to the Canadian subsidiaries of US companies. The US government's strategy was to compel the US parent company to make its Canadian subsidiary terminate all trade and investment with Cuba. The Canadian blocking order, however, created a potential legal defence for the US parent company against a US enforcement action that it was subject to foreign sovereign compulsion because its Canadian subsidiary was prohibited from complying with the extra-territorial provisions of the US embargo regulations. As a practical matter, the US restrictions could only be effective by prohibiting the US parent or other US persons from exporting US-origin components or technologies for use by the Canadian subsidiary in its trade with Cuba. Despite the blocking order, the significant influence of US-controlled investment in Canada, and the restrictions placed on Canadian subsidiaries by US sanctions, has inhibited Canada's economic relationship with Cuba.

Amendments to the Foreign Extraterritorial Measures Act

Canada instituted a number of challenges in the 1990s against the extra-territorial application of the Cuban embargo and Helms-Burton Act under NAFTA and the Charter of the Organization of American States (OAS),⁵⁰ and

⁴⁸ S.O.R./92-584, 9 Oct. 1992; Canada Gazette Part II, p. 4048 (1992 Blocking Order).

⁴⁹ R.S.C. 1985, c. F-29 (FEMA).

⁵⁰ The Organization of American States passed a resolution on 4 June 1996 calling on the Inter-American Juridical Committee to examine the Helms-Burton Act and report on its validity under international law. OAS Doc. CJI/SO/II/doc.67/96 rev.5 (23 Aug. 1996), reprinted in 35 *ILM* 1329 (1996).

joined a WTO challenge led by the European Union. In 1996, the Canadian Parliament broadened the scope of the 1992 Order to block the application of Helms-Burton legislation in Canada by adopting the *Act to Amend the Foreign Extraterritorial Measures Act*⁵¹ (Amending Act), which came into force on 1 January 1997.⁵² This legislation specifically places the Helms-Burton legislation on the 'Foreign Objectionable Laws' list.⁵³ Section 7 of the Amending Act also provides for the addition of section 7.1 to the FEMA, which states that:

Any judgment given under the law of the United States entitled *Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1996* shall not be recognized or enforceable in any manner in Canada.⁵⁴

The Attorney-General has offered protection to Canadian businesses and individuals affected by the legislation. The claw-back provision applies to permit Canadian entities, against whom judgments have been entered in US courts, to sue the claimant in Canadian courts for damages in the amount of the judgment. This right is codified in section 9 of the FEMA as follows:

Where a judgment in respect of which an order has been made under section 8 has been given against a party who is a Canadian citizen, a resident of Canada, a corporation incorporated by or under a law of Canada or a province or a person carrying on business in Canada, or an order has been made under section 8.1 in favour of such a party in respect of a judgment, that party may, in Canada, sue for and recover from a person in whose favour the judgment is given

(i) any amount obtained from that party by that person under the judgment,⁵⁵

Any judgment obtained could be exercised against any assets held in Canada by the US party. Canadian companies which are sued in the United States for matters relating to the Helms-Burton legislation are also permitted to

⁵¹ R.S.C. 1996, c. 28 (Amending Act).

⁵² Foreign Extraterritorial Measures (United States) Order, 1992, Amendment, SOR/96-84, 1996 Canada Gazette, Part II, p. 611. (ABO).

⁵³ Ibid., §8.

⁵⁴ Ibid., §7.

⁵⁵ FEMA, §9(1). Section 9 further provides that the party suing in Canadian courts can also recover all expenses incurred by them in defending the proceedings in the US and any loss or damage suffered by the party by reason of enforcement of the judgment.

seek recourse in Canadian courts against the US claimant for the costs, prior to the completion of proceedings in the United States.⁵⁶

If the Canadian companies have no assets in the United States, US authorities would have to ask the Canadian Attorney-General to enforce the judgment against the company's Canadian assets. The amendments to the FEMA authorise the Attorney-General to refuse any such request.⁵⁷ Alternatively, the Attorney-General may issue an order for enforcement of a judgment in a specific amount for the purposes of recognition and enforcement in Canada, but may in such order reduce the amount of the judgment to any amount which it deems appropriate.⁵⁸ Essentially, the effect of this provision is to allow the recognition of a Helms-Burton judgment in Canada but to eviscerate the judgement by reducing or even eliminating the amount of damages.

The Amended Blocking Order

The 1992 Blocking Order under the FEMA served essentially as a deterrent to Canadian companies by preventing them from complying with objectionable US legislation, and the Amended Blocking Order (ABO) was enacted in 1996 because it was felt that the 1992 Blocking Order was not strong enough to protect Canadian interests under the wider and more aggressively extraterritorial Helms-Burton Act. One of the concerns of the Canadian government with respect to the 1992 Blocking Order was that penalties under Helms-Burton were significantly higher than those under the Order. The government was concerned that some companies may comply with the US legislation as the lesser of the two evils.⁵⁹ In an effort to reduce the likelihood of such occurrence, the penalty provisions of the FEMA were significantly increased to allow Canadian courts to vary the amount of the penalty depending on the circumstances up to a newly increased maximum of

⁵⁶ FEMA, §9(1.1) provides as follows:

Where proceedings are instituted under an antitrust law, or a foreign trade law or a provision of a foreign trade law set out in the schedule, and no final judgment has been given under those proceedings against a party who is a Canadian citizen, a resident of Canada, a corporation incorporated by or under a law of Canada or a province or a person carrying on business in Canada, that party may, in Canada, with the consent of the Attorney-General of Canada, at any time during the proceedings sue the person who instituted the action and recover from that person all expenses incurred by the party in defending those proceedings and in instituting proceedings under this Act, including all solicitor-client costs or judicial and extrajudicial costs.

⁵⁷ FEMA, §8(1)(a) and 8(1.1)(a).

⁵⁸ FEMA, §8(1)(b) and 8(1.1)(b).

⁵⁹ T. K. & E. Shriver, 'LIBERTAD and the Cuban Assets Control Regulations vs. The Canadian Foreign Extraterritorial Measures Act – Collision Course or Near Miss?', paper presented in Toronto, 26 June 1996, p. 9.

\$1.5 million (Cdn).⁶⁰ This reduced some of the incentives to prefer Canadian over US penalties because the Canadian penalties could potentially exceed the maximum amount that can be imposed against US-controlled Canadian persons of one million US\$ under the Cuban embargo regulations. However, this may not provide much incentive to comply with Canadian law in the situation where Canadian investors have made significant investments in confiscated Cuban property that was once owned by US nationals if the value of the property is at least one million US\$ because under Helms-Burton the US claimant could recover at least the fair market value of the property and in some instances may recover treble damages. Moreover, the Amending Act also increased penalties through the imposition of personal liability to a maximum of \$150,000 (Cdn), or up to 5 years imprisonment, for directors and officers of corporations found to be in breach of the ABO.⁶¹

Corporate compliance

The ABO imposes an obligation on Canadian corporations and their officers and directors to report to the Attorney-General any 'directive', 'instruction', and 'intimation of policy' relating to an 'extra-territorial measure'. This creates an important corporate governance challenge for the board of directors in approving internal controls to ensure that there is no inadvertent compliance with extra-territorial measures. Significant issues arise regarding the definition of what constitutes an ability to direct or influence the policies of a corporation, as well as the ambiguity associated with the phrase 'intimation of policy'.⁶² Furthermore, the ABO also imposes a positive duty of non-compliance with the Cuban embargo regulations,⁶³ in the following provision:

No Canadian corporation and no director, officer, manager or employee in a position of authority of a Canadian corporation shall, in respect of any trade or commerce between Canada and Cuba, comply with an extraterritorial measure of the United States or with any directive, instruction, intimation of policy or other communication relating to such a measure that the Canadian corporation or director, officer, manager or employee has received from a person who is in a position to direct or influence the policies of the Canadian corporation in Canada.⁶⁴

⁶⁰ FEMA, §7(1).

⁶¹ FEMA, §7(1).

⁶² This notice is required to be written and to give details of the communication, including names and the full text. *Ibid.*, §4.

⁶³ Every Canadian corporation and every director and officer of a Canadian corporation shall forthwith give notice to the Attorney-General of Canada of any directive, instruction, intimation of policy or other communication relating to an extra-territorial measure of the United States in respect of any trade or commerce between Canada and Cuba. *Ibid* §3(1).

⁶⁴ *Ibid.*, §5.

More importantly, Section 6 of the ABO states that:

Section 5 applies in respect of any act or omission constituting compliance, in respect of any trade or commerce between Canada and Cuba, with an extraterritorial measure of the United States or a communication referred to in that section, whether or not compliance with that measure or communication is the only purpose of that act or omission.⁶⁵

This is extremely important, as it broadens the application and enforceability of the ABO by almost creating a reverse burden of proof whereby the Canadian company has to prove that any activity or omission was undertaken for purposes other than compliance with the Helms-Burton legislation. For example, a Canadian corporation might be tempted to decline potential Cuban business because it is encountering difficulty in establishing the Cuban customer's creditworthiness and believes it may encounter some difficulties servicing equipment that is the subject of the business proposal. Also, if the Canadian corporation is a subsidiary of a US parent, its officers would likely take into account the extra-territorial US restrictions on trade with Cuba in deciding whether to pursue a venture. Although all of these factors may equally influence a Canadian corporation's decision not to pursue a venture in Cuba, section 6 of the FEMA Order in effect diminishes the importance of non-embargo factors and seems to ascribe criminal liability to the Canadian corporation for any type of compliance with the US embargo.⁶⁶

Other significant features of the Canadian amendments to domestic legislation are the application of the ABO to services, instead of simply to goods as was the case in the 1992 Blocking Order. The provision of services is defined to include financial services and technology, and requires US subsidiaries operating in Canada to conduct normal business relations with 'specially designated nationals' that may be operating in Canada or other third countries as cloaks for, or on behalf of, the Cuban government.

Regarding the Helms-Burton Act, the most significant problem faced by Canadian companies subject to the conflicting commands of the US legislation and the Canadian FEMA concerns how to comply with both laws, which policies to avoid (or implement), and which activities are permitted or prohibited. The first cause of this uncertainty is that both sets of laws are deliberately drafted broadly with the intention of deterrence. As a result, it is difficult to know exactly what type of compliance measures should be

⁶⁵ *Ibid.*, §6.

⁶⁶ Some experts argue that section 6 seems to go too far in implying that Canadian companies are almost under an obligation to do business in Cuba.

adopted to avoid liability under both laws. For example, the communication provision of the ABO provides for the written notice to the Attorney-General of any 'directive, instruction, intimation of policy or other communication' received from someone in a position to influence the policies of the company. Someone in a position to influence has been interpreted as not being limited to parent-subsidiary relationships, and thus could be triggered by a company deciding not to pursue a Cuban investment for fear of future backlash from a potential investor in the United States. With respect to communication, it is difficult to know at what point a communication becomes reportable and the phrase 'intimation of policy' is ambiguous.

Individuals who are on the board of directors of both a US parent company and a Canadian affiliate or subsidiary are exposed to potential liability under both the FEMA and the US economic sanctions regulations. Indeed, the situation of interlocking directorships should be avoided because it exposes Canadian companies to the extra-territorial application of US economic regulations and in particular to the Helms-Burton Act. This is due to the fact that under Canadian legislation, directors can be found personally liable for contravention of the ABO. Personal liability was added to the ABO to enhance the deterrence for Canadian companies contemplating noncompliance with the 1992 Blocking Order. Interlocking directorships create a double jeopardy situation whereby the director can be personally liable in both countries for separate offences. For instance, the directors of a US parent could be liable under US law for the actions of the Canadian subsidiary in selling goods or services to Cuba, while at the same time being exposed to criminal liability in Canada for complying with the dictates of the US economic embargo of Cuba. As a result, the safest alternative for directors is to avoid interlocking directorships which could expose them to liability under both sets of laws.

Subsidiary relationships between US corporations and foreign subsidiaries are one of the specific targets of the Cuban embargo regulations (Glossop, 1996, 116–118). Aside from the communication and interlocking directorships issue already discussed, internal communication between related companies could be caught in the gap between the Canadian and US legislation. For example, a US parent company may issue an internal memorandum informing its Canadian subsidiary of US export restrictions, without any implication whatsoever that the Canadian subsidiary should be complying. Any response by the Canadian subsidiary seeking clarification or further information, could be seen as compliance with extra-territorial measures or of communications relating to restrictions on trade between Canada and Cuba, in contravention of sections 3 and 5 of the ABO.

In addition, Canadian companies may incur liability under US law for transferring technology transfer to Cuba which was developed in the United

States, or subject to US intellectual property rights. This would violate the US ban on US-origin components being exported to Cuba without a specific licence (despite the fact that the entire product was manufactured and originated in Canada or another foreign country). Helms-Burton specifically defines intellectual property as interests of 'property', but does not address the issue of whether US-developed technology would fall into the definition of US-origin components for the purposes of the Cuban embargo regulations. For example, if a Canadian computer manufacturer exports computers to the United States which include a US software package, it is possible that either the licensee exporting to Cuba, or the licensor who sold the software to the Canadian company face potential liability under the Helms-Burton Act and the ABO.

Regarding enforcement, the Canadian government has brought very few actions against Canadian corporations or individuals for violating the FEMA Order. There was a widely publicised case, however, that was subject to official comment involving the sale of Cuban-made pajamas being sold in Canadian Wal-Mart stores by the Canadian subsidiary of the US Wal-Mart corporation.⁶⁷ The Canadian operations of Wal-Mart received a directive from its US parent company to cease selling the pajamas and take them off the shelves because such sales constituted a violation of the Cuban embargo regulations. The Canadian Government pressured WalMart Canada to return the cotton pajamas to the stores and resume their sale, and then commenced an investigation into whether the action constituted a violation of the FEMA (Glossop, 1996, 111). The issue was rendered moot when the Canadian Wal-Mart stores elected to sell the pajamas despite the directive from their US parent. The US Department of Treasury decided not to prosecute Wal-Mart US for the violations of the trade embargo by its subsidiary.⁶⁸ Indeed, Wal-Mart Canada may have resumed its sales because of the threat of sanctions under the FEMA.⁶⁹

In other cases, however, the Canadian Government has been reluctant to bring enforcement proceedings under the FEMA against Canadian business entities that comply with the extra-territorial controls of US economic sanctions. Although the Canadian enforcement action against the Canadian subsidiary of Wal-Mart Canada attracted much publicity, there have been a number of cases where Canadian companies have announced their withdrawal from projects and joint ventures in Cuba because of potential liability under US sanctions. Overall, the extra-territorial application of the Cuban trade embargo and Helms-Burton law to Canadian persons presents important issues and problems for Canadian companies seeking to do business

⁶⁷ See Globe and Mail (1997).

⁶⁸ Ibid.

⁶⁹ Reuters Limited, 'U.S. Treasury, Wal-Mart Discuss Cuban Pyjamas' (16 March 1997).

with Cuba and will continue to constrain Canadian business activity in Cuba for as long as US economic sanctions remain in effect.

The European Union's response

The European Union (EU) has vigorously criticised the extra-territorial application of US economic sanctions as violating international law and international trade agreements. Indeed, when Congress was debating the Cuban Democracy Act in 1992, member countries of the European Community (EC) and the Community itself sought to dissuade President Bush from signing the Act into law after Congress had approved it. The EC Commission issued a statement that read:

Although the EC is fully supportive of a peaceful transition to democracy in Cuba, it cannot accept that the U.S. unilaterally determines and restricts EC economic and commercial relations with any foreign nation which has not been collectively determined by the United Nations Security Council as a threat to peace or order.⁷⁰

The EC Commission's view was that such US action that affected business carried on outside the territory of the United States 'would violate general principles of international law and the sovereignty of independent nations'.⁷¹ After President Bush signed the law in October of 1992, the Commission criticised the law on 28 October 1992 as 'unacceptable and incompatible' with the type of rules that should be regulating international trade.⁷² Similarly, the European Community Parliament also opposed with equal vigour the extra-territorial provisions of US law that extended the Cuban embargo to US-controlled subsidiaries operating in the EC.⁷³ The Parliament considered an economic embargo of Cuba to be a violation of international law because the United Nations Security Council had not designated Cuba to be a threat to international peace and stability.⁷⁴ In September of 1993, the Parliament adopted a resolution that called on the EC and its member states not to comply with the Act.⁷⁵ The resolution requested the EC

⁷⁰ Reuters, 8 Oct. 1992, 'EC Warns Bush Not to Ban U.S. Subsidiaries' Cuban Sales'.

⁷¹ *Ibid.*

⁷² BNA Daily Report For Executives, 28 Oct. 1992, 'Bush's Signing of Cuba Embargo Law May Trigger GATT Complaint', available in LEXIS, News Library, Drexec. File.

⁷³ In fact, on 18 December 1992, the EC Parliament passed a resolution urging Congress to repeal the Act. Agence Europe, 19 Dec. 1992, 'EP Asks That Clinton Administration Renounces Cuban Democracy Act', available in LEXIS, World Library, Txtline File.

⁷⁴ *Ibid.*

⁷⁵ *Int'l Trade Rep.*, 22 Sept. 1993, 'EC Parliament Calls on EC Members to Ignore U.S. Law Extending Cuban Embargo', p. 1573.

Commission to 'take the necessary legislative steps-following the examples of Canada and the United Kingdom – to ensure that European companies and companies established in the Community can carry out normal trading relations with Cuba'.⁷⁶ No further legal action was taken by the European Community until the Commission proposed an anti-boycott regulation in 1996 which was approved by the Committee of Permanent Representatives of the Member States of the European Union (COREPER)⁷⁷ on 22 November 1996 which aimed to block recognition and enforcement of the Cuban Trade Embargo, the Helms-Burton Act and the Iran/Libya Sanctions Act.⁷⁸

*European Union Regulation 2271/96*⁷⁹

The European Union's adoption of Regulation 2271/96 was part of an effort to neutralise the extra-territorial impact of US economic sanctions.⁸⁰ Regulation 2271/96 prohibits nationals or business entities of the European

⁷⁶ Ibid.

⁷⁷ The 'Committee of Permanent Representatives of the Member States (COREPER) is authorised by the Council of the European Union (the Council) to undertake studies and to prepare and submit proposals to the Council based on proposed regulations submitted by the European Commission. Treaty on European Union, 7 Feb. 1992, art. J.3, K.3, *OJ C* 224/1, 9495, 97–98 (1992), 1 *C.M.L.Rev.* 719, 730–731, 736, 31 *ILM* 247 [hereinafter TEU]. COREPER acts as a link between the Council and the EC Commission. Treaty Establishing the European Community, 7 Feb. 1992, art. 151 (1), [1992] 1 *C.M.L.Rev.* 573, 681 [hereinafter EC Treaty].

⁷⁸ See European Union: Council Regulation (EC) NO. 2271/96, Protecting Against The Effects Of The Extra-Territorial Application Of Legislation Adopted By A Third Country, and Actions Based Thereon or Resulting Therefrom, 1996 *OJ (L 309)* 39, at 36 *ILM* 125 (1997)[hereinafter EU Council Regulation No. 2271/96]. In responding to the European Commission's draft of the Regulation, EU Trade Commissioner Sir Leon Brittan stated:

We cannot remain inactive when this Sword of Damocles hangs over European companies and individuals. Today the Commission has responded quickly to Ministers' unanimous condemnation of the law by proposing a Regulation that will outlaw the Helms-Burton Act in Europe.

See *European Reports*, 1 Aug. 1996, at 9. In addition, because the Council believed that Regulation 2271/96 did not cover all types of activities that needed protection, it also adopted a Joint Action based on Articles J.3 and K.3 of the Treaty on European Union. See Joint Action of 22 November 1996, *OJ L 309/7* (1996)[hereinafter Joint Action].

⁷⁹ European Union: Council Regulation (EC) No. 2271/96, Protecting Against The Effects Of The Extra-Territorial Application Of Legislation Adopted By A Third Country, 22 Nov. 1996, 36 *ILM* 125 (1997). The Council of Ministers formally adopted the Regulation on 22 November 1996 and it became effective on 29 November 1996. Council Regulation No. 2271/96.

⁸⁰ The EU Regulation is entitled 'Protecting Against The Effects Of The Extra-Territorial Application Of Legislation Adopted By A Third Country'(The Regulation). The Council based this Regulation on Articles 73c, 113, and 235 of the Treaty establishing the

Community from complying with US economic sanctions that are designated in the Regulation's annex. As a result, European companies and persons with US property interests are potentially subject to two sets of laws with contradictory commands.⁸¹ When the Regulation was initially proposed, it was primarily intended to neutralise the Helms-Burton Act and the Cuban Assets Control Regulations, but, with the passage of the Iran/Libya Sanctions Act in 1996, it was designated to apply to that law as well.

The EU Regulation prohibited EU nationals and business entities incorporated in the EU from complying with Titles III and IV of the Helms-Burton Act and with the sanction provisions of the Iran/Libya Sanctions Act and, to the extent that it applies to EU nationals outside US territory, to the Cuban Embargo Regulations. The Regulation authorises nationals of European Community states to file countersuits in European courts against plaintiffs who have filed actions against them under Title III of Helms-Burton.⁸² Similarly, it allows EU persons who are subjected to US government enforcement actions for breach of US sanctions laws to file countersuits in European courts against the US government for any damages or penalties imposed as a result of the US action.⁸³ Moreover, the Regulation effectively blocks the recognition and enforcement within the EU of any judgment by a court or tribunal outside the Community which gives effect to the US legislation.⁸⁴ It also makes non-compliance with a judgment under the Act

European Community (EC Treaty). See Treaty Establishing the European Community, 7 Feb. 1992, art. 73c [1992] 1 *CMLR* 621. Article 73c of the EC Treaty provides:

Whilst endeavouring to achieve the objective of free movement of capital between member-States and third countries to the greatest extent possible and without prejudice to the other Chapters of this Treaty, the Council may, acting by a qualified majority on a proposal from the Commission, adopt measures on the movement of capital to or from third countries involving direct investment (including investment in real estate), establishment, the provision of financial services, or the admission of securities to capital markets.

Ibid. Moreover, Article 113 states: 'the Commission shall submit proposals to the Council for implementing the common commercial policy'.

⁸¹ The Council of Ministers' approval of the Regulation gives it binding force within the member states of the European Union.

⁸² See EU Council Regulation, art. 5. For example, an EU resident may recover all actual damages, including interest and attorneys' fees, caused by the application of the US sanctions by 'the natural or legal person or any other entity causing the damages or from any person acting on its behalf or intermediary'. The recovery of damages may include all compensatory damages, including penalties and treble damage awards, incurred by the EU person in a US action. The provision essentially allows for the recovery of the full amount of damages, including interest and legal fees, and not just the amount of compensation awarded by the US court.

⁸³ *Ibid.*, art. 6.

⁸⁴ *Ibid.*, art. 5.

obligatory and permits EU persons and companies to recover the amounts obtained by US nationals under Title III of Helms-Burton.⁸⁵

At the time the Regulation was adopted, the EU member states were among the most important trading partners of Cuba, Iran and Libya; they regarded the extra-territorial application of US sanctions under the Helms-Burton Act and the Iran/Libya Sanctions Act as an illegal attempt by the US to expand its jurisdiction. The main purpose of the Regulation was to eliminate the adverse effects of the extra-territorial application of sanctions imposed by the US against EU nationals for trading or investing in Cuba, Iran or Libya.⁸⁶ The Regulation is a binding part of the law of the European Union and poses difficult compliance challenges for European companies that do business with the US.

The Regulation contains provisions that should be of concern to all persons and business entities with a presence in one or more of the member states of the European Union. Member states are required to take protective action against the extra-territorial application of any legislation listed in Annex I.⁸⁷ This means that any EU national or resident person of the European Community is prohibited from complying with the Helms-Burton Act, the Iran Sanctions Act or the Cuban Embargo Regulations. Specifically, member states must prescribe penalties for EU nationals and companies in breach of the Regulation.⁸⁸ Although the European Commission had the power to prescribe such penalties directly in the Regulation, it decided to require member states to determine their own sanctions, which has led to disparate penalties across EU states.⁸⁹ Article 10 requires the mutual exchange of information on the implementation of the Regulation between member states and the Commission.⁹⁰

In addition, Article 6 authorises EU nationals or companies which have suffered damages resulting from US sanctions to countersue the responsible US party in a civil action in any member state of the European Union. This claw-back provision applies not only to judgments under Title III of Helms-Burton but also to any action which is brought and later settled without a final

⁸⁵ *Ibid.*, art(s) 5 & 6.

⁸⁶ Articles 7 and 8 require the European Commission to keep the Council of Europe informed of the effects of the US legislation and any actions which are based on it in the form of an annual report. The Commission will also be required to publish judgments to which Article 4 is applicable in the Official Journal of the European Community.

⁸⁷ The three sets of legislation currently listed in Annex I are: Titles I, III & IV of the Helms-Burton Act; ss. 1704 & 1706 of the 1992 Cuban Democracy Act; and the 1996 Iran/Libya Sanctions Act.

⁸⁸ *Ibid.*, art. 9.

⁸⁹ The Regulation requires only that the sanctions are 'effective, proportional and dissuasive'. *Ibid.*

⁹⁰ *Ibid.*, art. 10.

judgment. For example, if Barclays Bank Plc. is sued under Title III for financing transactions involving confiscated Cuban property and the suit is settled out of court, it will have a cause of action against the Title III plaintiff, or any person who acted on behalf of that plaintiff, in an EU court. When settling a Title III claim, therefore, plaintiffs may want to insert language in a release clause which absolves them from any liability in a subsequent 'claw-back' proceeding in an EU court. EU officials have stated, however, that such release clauses will not be recognised in EU courts. Moreover, it is important to note that the EU claimant cannot recover from a company incorporated under the laws of a member state of the European Community, if a US-based company of which the EU company is a subsidiary caused the damage.⁹¹ The rationale for this lies in European Community law which respects the separate legal entity status of a subsidiary from its parent or affiliate.

Article 6(3) authorises judicial proceedings to be brought in the courts of any member state where the defendant holds assets.⁹² Under Article 6(4), the EU claimant may seize and sell the assets of the person causing the damages to the extent that the EU national is fully compensated for whatever liability was imposed by a US court or agency.⁹³ The recovery may take the form of seizing shares held in a company incorporated within the European Community.⁹⁴ For example, if General Motors obtained damages against Fiat under Title III of Helms-Burton for Fiat's use of confiscated Cuban property, Fiat could not recover those damages from Opel, a German company in which GM owns shares, as Opel is a separate legal person incorporated in the European Community. However, any shares held by General Motors in the Opel company could be seized if those shares are held within the European Community.

When Regulation 2271/96 was under consideration, some member state representatives voiced disapproval of the claw-back provision because it shifted the power to retaliate against US economic sanctions away from the discretion of government ministers to the individual assessment of private persons. This view held that diplomatic efforts should have been the principal approach through which a resolution of the dispute should have been carried out, and that the right to 'hit back' through the claw-back provision at US plaintiffs would precipitate a counteraction by the US government or private plaintiffs in American courts. Unlike the claw-back provision in Article 6 of the British Act which did not permit recovery of compensatory damages in non-competition law cases, the EU Regulation provides that an EU person may recover all damages – compensatory or otherwise – that are

⁹¹ Ibid.

⁹² Council Regulation No. 2271/96, *supra* note 121, art. 6 (3), *OF L 309/1*, at 3 (1996).

⁹³ Ibid. art. 6 (4).

⁹⁴ Ibid. art. 6 (4), *OF L 309/1*, at 3 (1996).

incurred by a party as a result of a US enforcement action or private lawsuit based on conduct that occurred wholly outside of US territorial jurisdiction. The claw-back provision of Article 6 of the EU Regulation therefore affords a UK national a more attractive remedy for recovering damages resulting from the extra-territorial application of US sanctions than would parallel remedies under UK law.

If the US government institutes enforcement proceedings against a EU person under the Cuban Embargo Regulations or the Iran Sanctions Act, the EU claimant would have the right under Article 6 to countersue the US government in any court within the EU for all damages or penalties imposed by US sanctions laws. The US government would likely assert sovereign immunity as a defence and would argue that imposing sanctions is inextricably tied to the pursuit of its foreign policy and national security interests. Under these circumstances, US courts would probably not recognise an adverse judgment of a European Court. As a result, an EU claimant who obtains a judgment for damages against the US government under the Regulation may have achieved an empty victory, unless the claimant were able to enforce the judgment against US assets in Europe. The principle of sovereign immunity, however, would preclude a EU claimant from executing on US government property located in Europe as compensation for damages arising from the application of US sanctions if the attached property in Europe was used for a sovereign function (e.g., military bases).

The adoption of Regulation 2271/96 reflects a concerted effort on the part of the member states of the European Community to reject the application of extra-territorial US economic sanctions. Indeed, the Regulation in theory invalidates the legal effect of extra-territorial US sanctions on affairs within the European Community. The Regulation, however, has not had the intended effect of significantly deterring EU multi-national firms from complying with US sanctions. For example, many EU-based multi-national groups have not only assented to extra-territorial US controls but have actively pre-empted their application by entering licensing agreements and other arrangements with US authorities that minimise their US liability while permitting them to undertake certain transactions involving targeted states. For example, STET International (STET) and the ITT Corporation informed the US State Department in July 1997 that they had reached an agreement requiring STET to pay royalties to ITT over a ten-year period for its joint venture with the Cuban government to develop the Cuban telephone system.⁹⁵ As a result, the State Department terminated its ongoing investigation of STET's use of confiscated Cuban property. Similarly, the Dutch bank ING cancelled in July 1997 a line of credit worth over \$36 million to help

⁹⁵ See US Department of State statement by N. Burns (23 July 1997). STET (also known as Telecom Italia) owns a minority interest in the Cuban telephone company, ETESCA.

finance the annual Cuban harvest, fearing reprisals under the Helms-Burton law against the Dutch bank's assets in the US (EcoCentral, 1999). Subsequent reports in both cases stated the European Commission had no intention of recommending prosecution of STET or ING for its apparent compliance with Helms-Burton, despite their adoption of Regulation 2271/96.

Moreover, the increased application of extra-territorial US sanctions against third country firms doing business in Iran in the 1990s has led to under-investment in the Iranian oil and gas sectors, as Iran's oil refineries have become antiquated and its large gas reserves remain untapped. In recent years, however, Iran has become more successful in attracting some large non-US firms to invest in its energy industry. Although the major European energy companies – Royal Dutch Shell, BP, Total, and Repsol – remain reluctant to invest significant amounts in Iran because of the high cost of financing and the difficulty in transferring currency because of US sanctions, they have begun to reassess their options in response to the Iranian oil ministry giving them an ultimatum in early 2008 either to agree to major investment contracts by June 2008 or stand to lose these contracts to other foreign firms. To support this threat, Iran began concluding in 2007 a number of agreements with non-US foreign companies to invest substantial amounts in their energy and utility sectors. Sinopec, the Chinese state-owned oil company, agreed to invest \$2 billion to develop the Yadavaran oil field in south-western Iran, while Malaysia SKS Ventures has agreed with Iran's Pars Oil and Gas Company to a \$16 billion contract to develop a gas field. In March 2008, Switzerland's utility company, EGL, agreed to buy 5.5 billion cubic meters of gas a year for twenty five years, despite official US complaints. These recent deals suggest that many non-US firms are becoming less concerned with the threat of extra-territorial US sanctions and that the deterrent effect of extra-territorial US sanctions has greatly diminished.

III Blocking laws and foreign sovereign compulsion

The legal limits of US extra-territorial sanctions

The adoption of these blocking laws raises the important issue of whether third country persons who are subject to such laws can plead the defence of foreign sovereign compulsion to a foreign court in an effort not to comply with its extra-territorial laws. The US Supreme Court addressed the issue of foreign sovereign compulsion by examining a French blocking statute that precluded French citizens from disclosing evidence to United States courts.⁹⁶ The Court held that the French blocking statute did not preclude a US court

⁹⁶ *Societe Nationale Industrielle Aerospatiale v. United States District Court for Southern District of Iowa*, 482 U.S. 522 (1987).

from ordering a foreign party over whom the court exercised personal jurisdiction to produce evidence, even if producing the evidence violated the foreign blocking statute.⁹⁷ The Court reasoned that considerations of comity should only limit the extra-territorial reach of US pre-trial discovery orders in cases where international legal conventions on the exchange of evidence apply.⁹⁸ The Court's interpretation and handling of foreign blocking statutes in *Aerospatiale*, combined with the Court's analysis in *Hartford Fire Insurance*, implies that true conflicts and thus foreign sovereign compulsion must entail either dire repercussions for the foreign defendant or serious ramifications for US foreign relations.⁹⁹ Under this interpretation, a foreign party's mere inconvenience of having to choose between sanctions for violating a foreign blocking statute, or sanctions for not complying with a US court order, will not ordinarily be considered a true conflict. Regarding foreign blocking statutes, the Canadian Foreign Extraterritorial Measures Order (FEMO) directs Canadian businesses and their officers not to comply with extra-territorial measures of the United States affecting trade or commerce between Canada and Cuba and states that any US legislation that is likely 'to prevent, impede or reduce trade or commerce between Canada and Cuba' will be construed as an extra-territorial measure of the United States.¹⁰⁰ FEMO may seriously test the Hartford Fire true conflict rule (Fairly, 1996, 189–195). Under the Hartford Fire analysis, in the absence of a true conflict between domestic and foreign law, the assertion of extra-territorial subject matter jurisdiction can be validly assumed if Congress has expressly provided in the relevant statutory scheme that such jurisdiction should be imposed.¹⁰¹ As discussed in Chapter 7, Congress expressly created extra-territorial subject matter jurisdiction under both the Helms-Burton and Iran/Libya Acts in cases where third country persons are involved in certain commercial transactions and investments in Cuba, Iran or Libya. The true conflict rule was applied by the United States District Court for the Eastern District of Pennsylvania in *United States v. Brodie*, a case involving the application of the UK blocking statute against the application of the US Cuban embargo regulations.¹⁰²

In *Brodie*, the US Justice Department brought criminal charges against three individuals and one US corporation for conspiracy to violate the Cuban trade embargo and for certain transactions involving the sale of ion resins to Cuba through Canadian and UK companies.¹⁰³ The defendants

⁹⁷ *Ibid.*, at 543–547 & n29.

⁹⁸ *Ibid.*, at 543–546 & n29.

⁹⁹ *Ibid.*, at 543–544. See also Born (1992, 5), Dam (1993, 290–293).

¹⁰⁰ See R.S.C. ch. F-29 §§3–6, at 612–613.

¹⁰¹ See *Hartford Fire*, 509 U.S. at 797–799.

¹⁰² *United States v. Brodie et al.*, 174 F. Supp 2d 294 (2001).

¹⁰³ In the case, the four defendants, Stefan Brodie, Donald Brodie, James Sabzali, and the Brotech Corporation d/b/a as Purolite were convicted of conspiring (18 U.S.C.

sought dismissal of the charges on the grounds that the Canadian and UK blocking statutes compelled them not to comply with the US trade embargo of Cuba, and that the US courts lacked subject matter jurisdiction, and alternatively even if the US had jurisdiction the principle of international comity required that the charges be dismissed.

In his ruling, Judge McLaughlin cited the US case law on the foreign sovereign compulsion defence in which it was defined as shielding from civil liability ‘the acts of parties carried out in obedience to the mandate of a foreign government’.¹⁰⁴ To prevail on a foreign sovereign compulsion defence, he ruled that a party must show that: (1) the behaviour violating US law was actually compelled by the foreign government; (2) and the ‘foreign order was “basic and fundamental” to the alleged behaviour and not just peripheral to the illegal course of conduct’.¹⁰⁵ He cited the important US Supreme Court decision in *Societe Internationale v. Rogers*¹⁰⁶ in which the Supreme Court held that the foreign sovereign compulsion defence applied to Swiss bank secrecy laws where the Swiss Federal Attorney had confiscated financial records from a Swiss company to prevent it from being disclosed in a US civil court action and had threatened the company with prosecution. The Supreme Court held that in applying the defence a party must make a good faith effort to comply with US law even though it may be subject to the conflicting orders of two sovereigns. The court reasoned that a foreign party subject to foreign compulsion was in ‘an advantageous position’ to plead with its sovereign to relax its penal laws and devise a plan to comply generally with US law. Until the *Brodie* case, the foreign sovereign compulsion defence had never been invoked against an economic sanctions enforcement action.

In addition to being the first US court case that addressed the application of foreign blocking laws against the application of US economic sanctions, the *Brodie* case is also significant for how US enforcement authorities followed a diplomatically sensitive prosecution strategy in which they brought charges against the three individuals for conduct committed partially in the US, and which was not wholly extra-territorial, and against a US parent corporation, and not against its Canadian and UK affiliate companies, who had engaged through intermediaries in trade with Cuba. Although US prosecutors

section 371) to violate the US Trading with the Enemy Act 1917 as it applies to Cuba and committing multiple offences of causing the export of products to Cuba in violation of the Trading with the Enemy Act 1917.

¹⁰⁴ *Mannington Mills Inc. v. Congoleum Corp.*, 595 F. 2d 1287, 1294 (3rd Cir., 1979)

¹⁰⁵ *Ibid.*

¹⁰⁶ *Societe Internationale Pour participations Industrielles et Commerciales v. Rogers*, 357 U.S. 197 (holding that a Swiss company’s failure to comply with a US discovery order as part of a sanctions enforcement action did not warrant dismissal of the complaint even though the Swiss government contended that disclosure of the documents in question would violate Swiss banking secrecy law).

could have brought charges against the UK and Canadian affiliates and one of the Canadian individuals for acts committed in their respective countries, they decided not to do so because such an action could have potentially created a direct challenge to the blocking laws of Canada and the UK—two countries with whom the US has friendly relations.

US authorities also maintained in the case that because the foreign sovereign compulsion defence has always been based on foreign relations considerations, its decision to bring criminal charges in this case had reflected an adequate weighing and balancing by the executive branch, and that the US government had decided in this particular case that the benefits to US foreign policy in bringing the prosecution outweighed the potential costs or injury to relations with Canada and the United Kingdom. Moreover, the court cited the diplomatic communications between Canada and the US to show that the US had considered and accepted the views of the Canadian government that the US should not prosecute the Canadian citizen and Canadian affiliate company for acts they committed wholly in Canada over a certain period of time, while Canada did not object to the US prosecuting the Canadian citizen for acts committed wholly in the US after he had returned to the US to work for the US corporate defendant.

The court similarly applied diplomatic and foreign policy considerations in deciding to reject the defendants' argument that international comity required it to dismiss the case. In so doing, the judge applied the ten factor comity balancing test to determine whether the US government's enforcement action should be dismissed on international comity grounds. The court noted that although all ten factors were applicable, it put special emphasis on the following: *the relative importance of the alleged violation in the US compared with the foreign jurisdiction, the availability of a remedy in the foreign country and the pendency of any litigation there, would the exercise of extraterritorial jurisdiction by the US court substantially harm US foreign relations, and whether there was an applicable treaty that could resolve the dispute*. The court accepted the US position that it had weighed these factors adequately before bringing the enforcement action.

The defendants also addressed the comity issue by arguing that the *Hartford Fire Insurance* case provided a new standard of analysis for deciding comity that involves two issues: whether the alleged conduct occurred extra-territorially, and whether the actors in question were able to comply with both the extra-territorial US law and their domestic law. Judge McLaughlin however rejected this interpretation of *Hartford Fire* by stating that the Supreme Court did not intend to replace the ten factor balancing test with a shorter test, but rather that it had applied one of the ten factors to show that the foreign person in question was not being 'forced to perform an act illegal in either country or be under conflicting requirements by both countries'. Based on this factor, the defendants' comity argument failed

because they were not able to prove that the Canadian or UK governments had required them to trade with Cuba.

The *Brodie* case clarifies some of the ambiguities in analysing the true conflict test and its relation to the foreign sovereign compulsion defence. The 'true conflict' standard established in the *Hartford Fire* case and later reaffirmed and more precisely defined in *Brodie* provides some guidelines and principles for courts and regulators for determining whether a true conflict exists and thus whether a non-US person in a foreign country may rely on the foreign sovereign compulsion defence against US enforcement of extra-territorial economic sanctions.

The WTO option

In 1997, Canada, Mexico and the EU threatened to employ the dispute resolution mechanisms of international trade agreements against the US to determine whether Helms-Burton violates US treaty obligations. For example, Canada and Mexico invoked the dispute resolution procedures of Article 1105 of the North American Free Trade Agreement (NAFTA) to determine whether the sanctions of Title(s) III and IV treat Canadian and Mexican investors in accordance with international law. In October 1996, the EU requested formal bilateral consultations with the USA in the World Trade Organisation (WTO) for possible US violations of WTO provisions regarding restrictions on international trade.¹⁰⁷ The WTO appointed arbitrators to hear the EU complaint. In April, the EU suspended its WTO action for six months after it had reached agreement with the US on a set of 'binding disciplines' for negotiating a settlement on the use of US sanctions against EU nationals for benefiting from the use of confiscated property. By October of 1997, the EU and US had failed to reach agreement and referred the matter for review by the Organisation of Economic Cooperation and Development.¹⁰⁸ After extensive negotiations under the auspices of the OECD, the US, EU, Canada and Japan announced an agreement at the OECD G8 Summit on 18 May 1998 in which, *inter alia*, President Clinton agreed to press Congress for changes in both Title(s) III and IV of Helms-Burton in return for the EU's establishing a system to discourage Europeans from investing in confiscated Cuban property by denying them subsidies, risk insurance and diplomatic

¹⁰⁷ See 'EU to Seek WTO Consultations with U.S. over Cuba', *European Union News*, taken from *EU News*' Homepage at <http://www.bso.com.eu/news/press/pr29-96.htm>, 17 Sept. 1996 (quoting a 3 May 1996 letter from Ambassador Hugo Paemen, Head of the European Commission's Washington Delegation, to US House Speaker Newt Gingrich).

¹⁰⁸ As part of its investigation, the OECD undertook a study in which it planned to promulgate guidelines by the middle of 1998 to its member states for how they should regulate transactions involving confiscated property and to set standards on the extra-territorial use of US economic sanctions. See Chapter 9.

advocacy (Bennett, *New York Times*, 1998).¹⁰⁹ Moreover, as discussed in Chapter 9, the agreement provides a set of disciplines to govern EU and US policy and equally important a framework for dialogue and negotiations between EU and US over US economic sanctions policy and its extra-territorial application. Despite the success of some blocking laws in neutralising US sanctions, most major multi-nationals that operate in the US and in other third country states have entered agreements with US authorities that allow them to undertake certain transactions involving targeted states so long as they comply with the basic prohibitions of US sanctions laws. These agreements are evidence of the effectiveness of US sanctions in bringing about a certain degree of compliance by non-US-controlled multi-national enterprises. US authorities, however, have in recent years taken a softer approach with European and Japanese companies by not imposing sanctions directly against them for trading or investing with US-targeted states and entities, but nevertheless continue to exert pressure on them.¹¹⁰ In some cases, though, US officials impose severe sanctions, such as the \$80 million dollar fine on the Dutch bank ABN AMRO for financing payments for the Iranian government in violation of extra-territorial US sanctions. Indeed, it is such exposure to civil and criminal liability by third country businesses that prompted the governments of the G-7 countries to undertake negotiations in the late 1990s to adopt non-binding ('soft law') agreements that reaffirmed the principles and objectives of US sanctions and provided a basis for the development of a multilateral sanctions regime that recognised the necessity of economic sanctions to address certain fundamental breaches of international law and threats to international political stability.¹¹¹ This can be explained in part by the post-11 September environment in which US authorities have required increased cooperation from Europeans in

¹⁰⁹ Specifically, the US agreed to request Congress to amend Title III so that the president could indefinitely waive the filing of lawsuits by US nationals against those profiting from the use of expropriated property. Similarly, President Clinton undertook to request Congress to amend Title IV to authorise the President to waive indefinitely the revocation of travel visas by the State Department against foreign nationals who profit from the use of expropriated property. Under current law, the State Department is required to investigate all foreign companies doing business in Cuba and to make a list of all foreign nationals who are known to benefit from the use of expropriated property with the ultimate aim of denying them the right to travel in the US.

¹¹⁰ House of Lords Select Committee on Economic Affairs, *The Impact of Economic Sanctions* (9 May 2007) p. 27 (citing John Cridland of the British Confederation of British Industry who said that it was 'offensive' that the US administration should seek to apply US sanctions and other legal requirements on non-US companies, but that US sanctions had 'been policed by US authorities in quite a sensitive way'.

¹¹¹ The principles of these soft law agreements are incorporated into two mutual assistance agreements that were adopted in 1997 and 1998 by the European Union and other G-7 countries with the US and will be analysed in Chapter 9.

confronting the threat of international terrorism and terrorist financing. Nevertheless, British industry representatives have observed that 'extra-territoriality' is a strong concern and that the application of extra-territorial US sanctions legislation was increasing, despite the existence of EU and UK blocking legislation. The only way forward from the regulatory and legal risks of extra-territoriality is to devise a multilateral sanctions regime to govern state sanctions policy. The first steps in this direction have been taken with respect to financial sanctions against terrorists and their supporters that will be discussed in Chapter 11.

Conclusion

This chapter analysed the blocking statutes and regulations of several major jurisdictions in confronting the extra-territorial application of US economic sanctions. Many major states have enacted blocking statutes that intend to bar the extra-territorial reach of US economic sanctions upon their governments, citizens and corporations. Blocking statutes protect the enacting country's commercial interests by preventing the recognition or enforcement of US judgments, orders and legislation, and prohibiting third country persons from complying in any way with extra-territorial US regulation. To enforce such prohibitions, blocking statutes typically impose civil penalties and monetary sanctions on third country citizens and business entities that seek to comply with proscribed US regulations. Although the adoption of these laws has had a normative impact on the international legal system insofar as they represent formal rejections by specially affected states of extra-territorial US sanctions, most blocking laws have not been consistently enforced against extra-territorial US sanctions (except perhaps the Canadian FEMA). Nevertheless, the blocking laws have been an effective political remedy in demonstrating to US authorities that third countries will not accept overreaching US extra-territorial regulation lightly. In most areas of extra-territorial US regulation, US authorities have taken a softer approach, but still exert diplomatic pressure against European and Asian businesses to cease doing business with US-targeted states. Moreover, the direct conflict of laws in this area necessitates an effective multilateral approach for resolving the unilateral sanctions problem.

9

Mutual Assistance and Economic Sanctions

Introduction

Chapter 8 analysed the legal responses of some leading states in resisting the extra-territorial application of US economic sanctions by adopting blocking laws and clawback statutes that are designed to neutralise the extra-territorial effect of such laws in the home jurisdiction. Although these laws at least in theory appear to block the extra-territorial assertion of US sanctions in regard to third country trade and investment with US-targeted states, they have had little practical effect in insulating third country businesses from potential liability under US sanctions. Indeed, there are various reasons why third country blocking laws have failed to shield third country entities, but the most prominent reason appears to be that most blocking laws and regulations have not been implemented or consistently enforced in their jurisdictions. Moreover, the *Brodie case* shows how US authorities have enhanced the effectiveness of extra-territorial sanctions by selectively enforcing sanctions against foreign persons and entities that have used US territory for part of their transactions with US-targeted states, while not attempting to enforce sanctions against foreign persons whose transactions occur solely in another country with blocking laws. Consequently, some major multinational firms with operations in Canada and the European Union have entered agreements with the US government that seek to reduce their liability exposure under US sanctions in return for their compliance with certain requirements of US sanctions law. Nevertheless, third country blocking laws have attracted widespread publicity and there are some indications that they have caused US regulators to exhibit more restraint in their extra-territorial enforcement of sanctions.

It has been argued throughout this study that the application of national economic sanctions laws has often created foreign policy and legal and regulatory disputes between states which have been exacerbated by the absence of an effective international legal and institutional framework to

co-ordinate sanctions practice. For instance, the adoption of blocking laws by the EU, Canada and other countries against extra-territorial US sanctions has created a clash of jurisdictional power between the world's major developed countries that has created enormous compliance challenges for most of the world's largest multi-national firms and enterprises. In the 1990s, many multi-national firms and financial institutions based in Europe, the US and across Asia began lobbying the G7 governments to resolve some of the main issues that had divided the EU and other states from the US over unilateral economic sanctions. By 1997, the G7 states began to negotiate bilateral agreements that addressed some of the main concerns of US economic sanctions and the need for the EU and other G7 states to increase their trade and investment controls with certain states that had infringed important principles of international law and threatened international security interests. These diplomatic negotiations have improved co-ordination between the G7 and EU states and have harmonised certain economic sanctions practices and have defused some of the tensions surrounding extra-territorial US sanctions. This chapter examines these efforts as they relate to efforts at mutual assistance by the European Union and United States to build a multilateral sanctions regime that targets states that are in breach of international law and threaten the stability of the international system. The chapter begins by discussing some of the principles and concepts on which mutual assistance agreements are based and some examples of mutual assistance in state practice that address extra-territorial economic sanctions. Further, it analyses the 1997 Memorandum of Understanding between the EU and US over extra-territorial US economic sanctions and the 1998 Mutual Assistance Agreement between the US and the G7/EU states regarding the adoption of certain investment and trade disciplines and restrictions against certain states that have violated principles of property protection under international law and have breached weapons of mass destruction treaties and provided support for international terrorism. These agreements provide a multilateral framework through which states can co-ordinate the application of their sanctions policies and avoid some of the legal and regulatory difficulties surveyed in this study.

I Economic sanctions and bilateral cooperation

Mutual assistance agreements

Mutual assistance agreements can take various forms, the most common of which are the memorandum of understanding (MOU) and the mutual legal assistance treaty (MLAT). The MOU is a well-accepted type of legal instrument in international law and practice. Indeed, it was recognised as such by the British lawyer Lord McNair, who, in his classic work on the law of treaties, identified the MOU as 'an informal but nevertheless legal agreement'

between two or more parties (McNair, 1961, 15).¹ In its commentary on what became the 1969 Vienna Convention on the Law of Treaties, the International Law Commission recognised that MOUs ‘are undoubtedly international agreements subject to the law of treaties.’² According to McNair and, indeed, by the terms of the Vienna Convention itself, it is not the title or other appellation given to a diplomatic document that determines whether it is of a legally binding nature; rather, the determinative factor is whether the drafters intended to conclude an agreement in written form governed by international law.³ By contrast, some leading British commentators took the view that the ILC draft may not have been ‘wholly correct’ in stating that an MOU ‘was “undoubtedly” an international agreement subject to the law of treaties (Oppenheim 1992, 1209 fn 8).’⁴ Nevertheless, mutual assistance agreements – whether binding or hortatory – often espouse norms, standards and principles of state practice that often are eventually transmitted into policies of other non-party states, thereby supporting the view that such agreements may, when espoused by leading states with significant economic and political influence, reflect emerging or established principles and norms in the international system. Since the 1970s, there has been a vast increase in the number of mutual assistance agreements to address a variety of international policy concerns, such as money-laundering, insider dealing, tax evasion, complex fraud, and bribery and corruption (McLean, 2002).

Mutual assistance and economic sanctions

The necessity of mutual assistance in matters related to economic sanctions has become apparent in recent years as more countries adopt economic sanctions to promote foreign policy objectives and to comply with UN Security Council resolutions. The US and other countries consider mutual assistance to be necessary to provide a political and legal framework to

¹ As an example, he discussed the Memorandum of Understanding Regarding German Assets in Italy (29 Mar. 1957), UK-Fr.-It.-US., 8 UST 445, 283 UNTS 137. See also H. Blix & J.H. Emerson (1973, 7 and 316) (describing MOUs as a type of instrument resembling treaties).

² *Yearbook of the ILC*, 1965, vol. 1, pp. 10, 14.

³ See Vienna Convention on the Law of Treaties, *opened for signature* 23 May, 1969, Art. 2(1)(a), 1155 UNTS 331, *reprinted* in 8 *ILM* 679, 681 (1969). See also Report of the International Law Commission to the UN General Assembly, [1966] 2 *Yearbook of the ILC*, 188, U.N. Doc. A/CN.4/Ser.A/1966/Add.1.

⁴ L. Oppenheim’s *International Law*, vol. I, p. 1209 n.8, eds., R. Jennings & A. Watts (9th ed. 1992). Over thirty different names for treaties have been identified, and their use has ordinarily been a matter of diplomatic nuance. S. Rosenne, ‘Vienna Convention on the Law of Treaties’, in (instalment) 7 *Encyclopaedia of Public International Law* in R. Bernhardt, ed., *Encyclopaedia of Public International Law* (1984) 525, 527.

promote a state's economic sanctions policy beyond its own borders. Mutual assistance is necessary in today's globalized financial markets and trading systems where payment systems have become more integrated and the scope of many companies' activities now transcend multiple jurisdictions. The increasing integration of the world economy, especially in developed countries, is enabling regulators and law enforcement authorities to extend their influence over a wider area of economic activity that often involves regulatory conflicts between jurisdictions and compliance difficulties for companies operating in different countries. For most countries, economic sanctions can be a formidable threat to other countries, especially those countries with strong trading and financial links with the country seeking to impose the sanctions. Extra-territorial sanctions can impose additional costs on third country states that are not the direct target of the sanctions but whose trading and economic activities are undermining the economic sanctions policies of another state.

As discussed in the last chapter, third country states have resorted to blocking laws that purport to neutralise the extra-territorial effect of US sanctions, but this has not significantly reduced the liability exposure of third country companies to extra-territorial US sanctions. Consequently, mutual assistance is not only in the interest of the state seeking to enforce its laws extra-territorially, but also very much in the interest of third countries whose international trade policies are constrained by the broad reach of US trade regulation and for whom reducing liability risks is an important aspect of expanding international business. In fact, these countries and their businesses acknowledge that the substantial economic and political influence of the US makes it very difficult, if not impossible in some circumstances, for third country nationals to be insulated from the broad sweep of US law (Boissons De Chazournes 1995).⁵ This was demonstrated in the 1980s when some countries recognised extra-territorial US export controls as a *fait accompli* and accordingly adopted regulations that effectively resulted in their nationals being subjected to their dictates (Weiss-Tessbach and

⁵ See also, Americas Review of World Information, (Mar. 1998) (article discussing the substantial reduction in European bank lending to Cuba and in particular the decline of \$130 million annually in trade finance for Cuban sugar industry; 'Caribbean-Latin America: Regional Assault on Helms-Burton Act' (Oct. 7, 1997), Inter Press Service (discussing Mexican cement company Cemex withdrawing its investments from Cuba because of Helms-Burton). The Spanish bank, Banco Vizcaya, cancelled its \$8 million trade finance programme for Cuban agriculture because of its potential Helms-Burton liability due to sugar crops originating from Cuban lands that were confiscated. In 2006, two of the world's largest non-US banks, UBS and Credit Suisse, announced that they would cease doing business with Iran and facilitating transactions on behalf of the Iranian government and Iranian persons.

Heidinger, 1992, 39).⁶ For example, as discussed in chapter 8, the extra-territorial application of the US Helms-Burton Act was acquiesced in by the EU Commission and Italian Government when they refused to enforce the mandatory blocking orders of EU Regulation 2271/96 against the Italian telecommunications company STET after it had entered into a licensing agreement with the US corporation IT&T that required STET to pay 25 million US\$ to IT&T over a 10-year period for STET's investment in and use of the Cuban telephone system. As consideration for these payments, IT&T relinquished any future claim it may have had against STET under the Helms-Burton Act for its use of confiscated Cuban property.⁷ Similarly, the Dutch government has refused to take action against the multinational bank ING for its decision in October of 1998 to cease providing credits, loans and other financing for the Cuban sugar industry's annual harvest (amounting to over nine million US\$ annually) because of its exposure to civil and criminal liability under Helms-Burton and the OFAC regulations.⁸ In 2004, the Dutch banking conglomerate ABN Amro agreed to pay a fine of 80 million (\$US) to the US Federal Reserve and the OFAC because its Dutch headquarters had facilitated US dollar payments on behalf of Iranian government entities. These cases suggests that mutual assistance and improved multilateral co-operation in the area of economic sanctions serves not only US interests but also the interests of third country states whose international trade with US targeted states remains encumbered by the extra-territorial application of US economic sanctions.

II Economic sanctions: recent history of US efforts at mutual assistance

The Diefenbaker-Eisenhower Agreement

The first formal efforts to negotiate a mutual assistance agreement since the World War II regarding economic sanctions and export controls were embodied in the 1958 Eisenhower-Diefenbaker 'Joint Statement on Export Policies' (Brewster, 1960, 23). It became known as the Diefenbaker-Eisenhower Agreement and resulted from a dispute over the Trading with the Enemy Act in a case involving the US government ordering Ford (America) to prohibit its wholly-owned subsidiary Ford (Canada) from exporting Ford trucks to the People's Republic of China. The agreement

⁶ See O. Weiss-Tessbach & F.J. Heidinger, 'Austria National Report' in K.M. Meessen, (ed.) *International Law of Export Control* (1992) 39.

⁷ Italy's STET Dodges CUBA Sanctions (1997) *European Rep.*, July 26, 1997, Lexis/Nexis, Lib: News; File: Curnws. (visited 3 Mar., 1999).

⁸ See *Financial Times Asia Intelligence Wire*, January 1, 1998, *Cuba Review 1998*, Lexis/Nexis, Lib: News; File: Curnws. (visited 3 Mar., 1999).

sought to protect Canadian companies from being prejudiced by the extra-territorial application of US sanctions. It stated in relevant part:

If cases arose in the future where the refusal of orders by companies operating in Canada might have any effect on Canadian economic activity, the United States government would consider favourably exempting the parent company in the United States from the US foreign assets control regulations.⁹

As part of the agreement, a consultation procedure was established whereby a US parent company could, with Canadian government support, apply to the US Treasury Department for a specific licence to exempt the parent corporation, its officers and directors from legal liability, thus allowing the Canadian subsidiary to complete the sale without breaching the sanctions regulations. The agreement's intent was to depoliticise future conflicts over extra-territorial export controls and to reduce diplomatic tensions, but the legal effect of extra-territorial US sanctions remained binding by restricting or prohibiting all financial and commercial transactions involving US-controlled Canadian persons with US-targeted states. Although licences were granted from time to time, the principle of extra-territoriality was maintained, and applications for specific licences were only considered on a case-by-case basis with no promise of approval. The US government, however, did acknowledge that it would give preference to licence applications for US-controlled Canadian subsidiaries in cases where the denial of such a licence would have a substantially detrimental impact on the Canadian economy, and if the restricted transaction could only be performed by a US-controlled entity (Brewster, 1960, 26). Although this agreement constituted the basis for improved co-operation between Canada and the US over extra-territorial export controls and sanctions, the use of consultative procedures to obtain licences from OFAC for US-controlled Canadian subsidiaries were utilized less often in the 1970s, especially after the Canadian government adopted its first blocking-type statute, the Combines Investigation Act, which forbade Canadian companies from recognising foreign judgments, laws or directives, which would adversely affect competition or trade (Ibid., 28). Canadian resistance to US sanctions policy also arose from the growing number of US court cases in the 1960s and 1970s that recognised and enforced the application of US sanctions against firms and persons in the US for their business activities with US targeted states.

Efforts at Canadian-US mutual assistance collapse

As the Soviet pipeline crisis heightened in the early 1980s and Libyan terrorist activity increased, the Canadian government rejected US overtures at

⁹ Canadian House of Parliament Debates (July 11, 1958) p. 2142.

mutual assistance that were based along the lines of the Diefenbaker-Eisenhower Agreement because it viewed such agreements as reaffirming extra-territorial US policy. Moreover, it viewed the continuous use of the effects doctrine as an infringement of its sovereignty and denied that it could be made the basis for determining claims to extra-territorial jurisdiction under international law. Although jealously guarding its policy, Canadian policy cannot be described as strictly territorial. In determining claims to extra-territorial jurisdiction, the Canadian government and its courts have emphasised a balancing of interests between states, rather than direct conflict. The basis of conflict-avoidance is co-operation. This was described in a diplomatic note by the Canadian Embassy to the US Department of Justice in 1983 in the following terms:

The Government of Canada and the Government of the U.S. have long cooperated with respect to export controls, following the 1942 *Hyde Park Agreement*. This is manifest in the treatment that is accorded each country in the administration of the export control laws of the other. Generally speaking, pursuant to the *Hyde Park Agreement*, U.S. goods are exported to Canada without U.S. export licences, and vice versa. To prevent the circumvention of U.S. controls, Canada regulates the re-export of controlled U.S.-origin goods. This system has benefited both countries. It has helped to maintain bilateral trade flows free of the impediment of export licences, while still safeguarding mutual security objectives.¹⁰

Moreover, the Canadian government has only been willing to enter negotiations with the US government on the basis of reciprocity in which it will only recognise the extra-territorial effect of US sanctions if the US government also agrees to recognise the extra-territorial effect of Canadian sanctions. This position was expressed in a Note to the Department of State in 1983 as follows:

The Government of Canada believes that extraterritorial problems and conflicts of jurisdiction would be greatly limited if the United States would take due account of the principle of reciprocity and assert unilaterally its jurisdiction over conduct outside its territory only in circumstances where it would be prepared to recognise and accept, in similar circumstances and on the same basis, the same unilateral assertion of jurisdiction by another state over conduct within United States territory.¹¹

¹⁰ Diplomatic Note No. 139 of Canadian Embassy (Washington DC) to the US Department of Justice (May 4, 1983).

¹¹ Diplomatic Note of the Canadian Embassy to the US Department of State on 7 July 1982.

The US government rejected this proposal for mutual assistance based on the principle of reciprocity because it feared extra-territorial Canadian controls over international commerce in the US involving Canadian-controlled US businesses. Since the time of those failed negotiations in the 1980s, the Canadian government has consistently adhered to the principle of self-restraint and non-interference which accord with its view of international law (*Ibid.*). After the enactment of the Cuban Democracy Act and later the Helms-Burton Act, the Canadian government reiterated these positions in various diplomatic notes made directly to the US government and in negotiations within multilateral institutions, such as the Organisation for Economic Cooperation and Development. Indeed, it is difficult to understand why the US government would refuse to enter a bilateral agreement with the Canadian government based on the principles of reciprocity when it was known by US officials that Canada had long adhered to a policy of self-restraint and non-interference with respect to its use of economic sanctions. On the other hand, US officials perhaps feared that by assuming such obligations they would have been exposed to Canadian retaliation when the US sought to impose its foreign assets control regulations against US-controlled Canadian persons. This view is supported by Canada's reaction to the Helms-Burton Act when it instituted dispute resolution proceedings under the aegis of the North American Free Trade Agreement (NAFTA) that argued that the extra-territorial provisions of Title III and IV of Helms-Burton and the control liability provisions of the Cuban embargo regulations violated specific provisions of NAFTA and customary international law.

The pipeline dispute

In the early 1980s, at the height of the controversy concerning the extra-territorial application of US export controls over products and technology to be used on the European-Soviet Siberian pipeline, the US government undertook several initiatives with pro-western and non-aligned countries for the purpose of adopting bilateral agreements that would establish procedures for information exchange regarding the compliance of third country nationals with US export controls. Most of these initiatives failed to produce any agreements because of objections by many third country governments to the extra-territorial application of US export controls over US-origin technology and component parts that had been purchased or licensed from US persons by third country persons. Moreover, other countries not only denounced the extra-territorial nature of US sanctions, but also the overall US policy of using economic embargoes and export controls to accomplish foreign policy objectives. Yet, some countries, such as Austria, expressed the view that criticism of US policy should be based solely on the extra-territorial features of US sanctions policy and not on the foreign policy objectives of the US government (Weiss-Tessbach and Heidinger, 1992, 39).

III EU-US mutual assistance in the 1990s

In the 1990s, EU-US relations over US economic sanctions had deteriorated in the aftermath of Congress enacting the Helms-Burton Act 1996 and the Iran/Libya Sanctions Act 1996. EU objections to both pieces of legislation resulted in the EU filing a complaint before the World Trade Organisation that US extra-territorial sanctions under these acts violated US obligations under the WTO Agreements. Similarly, Canada and Mexico filed complaints against the US that the US trade embargo against Cuba and the Helms-Burton and the Iran/Libya Sanctions Act violated US obligations under the North American Free Trade Agreement (NAFTA).

1997 Memorandum of Understanding

In April 1997, the NAFTA and WTO proceedings were put in abeyance when the US and EU/G7 states adopted a Memorandum of Understanding (MOU) containing a set of non-binding disciplines¹² that provided a framework for resolving the conflicts over extra-territoriality and building a multilateral regime to isolate pariah states. The 1997 MOU stated in relevant part:

(1) to step up their efforts to develop agreed disciplines and principles for the strengthening of investment protection, bilaterally and in the context of the Multinational Agreement on Investment (MAI)¹³ or other appropriate international fora (regarding Helms-Burton); and (2) to work together to counter the threat to international security posed by Iran and Libya (regarding Iran/Libya Act).¹⁴

The US reiterated its willingness to continue its suspension of Title III of Helms-Burton, relating to 'trafficking' in expropriated US properties, during the remainder of President Clinton's second term, and agreed to consult with Congress with a view to amending the Act to authorise the President to waive Title IV, which prohibits travel to the US by foreigners 'trafficking' in expropriated US properties. With respect to the Iran/Libya Act, the US stated its intention to implement the statute in a deliberate and fair manner

¹² 'Discipline' is a term used in international economic law to describe a set or system of rules or regulations. See Webster's Encyclopaedic Unabridged Dictionary of the English language (1996) 562.

¹³ The 1997 MOU and 1998 Mutual Assistance Agreement were negotiated under the auspices of the Organisation for Economic Cooperation and Development's negotiations for a Multilateral Agreement on Investment (MAI). Although MAI negotiations broke down in February of 1999, the G7 and US were able to adopt the 1997 MOU and the 1998 agreement.

¹⁴ Memorandum of Understanding concerning the U.S. Helms-Burton Act and U.S. Iran/Libya Sanctions Act (11 Apr., 1997), EU-US, *reprinted in* 36 *ILM* 529, 529-30 (1997), 91 *Am. J. Intl' L.* 498 (1997) [hereinafter 1997 Understanding].

that takes into consideration US international obligations. Moreover, it reiterated its commitment to work with EU member states, Canada and Japan to establish conditions under which these third countries and their companies and nationals would not be subject to extra-territorial sanctions if they undertook a review of their investment policies with US-targeted countries. The 1997 MOU was viewed as an interim measure that would provide a general framework of principles to which the parties would adhere while pursuing negotiations for a more final agreement.¹⁵

1998 EU/US Mutual Assistance Agreement

During the G7 Summit in May of 1998, an Agreement¹⁶ was concluded between the EU/G7 states and the United States which appeared to resolve their dispute concerning Helms-Burton and the Iran/Libya Act. The 1998 Agreement consists of two Understandings which further developed the principles of the 1997 MOU by addressing the extra-territoriality of US sanctions and the adoption of third country restrictions on investment in Cuba, Iran and Libya. The First Understanding was entitled 'Understanding on Conflicting Requirements', which contains, *inter alia*, the 'Transatlantic Partnership on Political Cooperation'.¹⁷ The Second Understanding was entitled 'Understanding with Respect to Disciplines for the Strengthening of Investment Protection' and four annexes: Annex A, Registry of Claims Alleging Expropriation in Contravention of International Law;¹⁸ Annex B,

¹⁵ As a condition for entering the agreement, the EU and Canada agreed to suspend their dispute resolution complaints before the WTO and NAFTA respectively for a six month period until a more final agreement could be reached. Both countries, however, promised to renew the complaints if satisfactory progress had not been reached by November of 1997. After no agreement was reached by the deadline, the parties allowed the Organisation for Economic Cooperation and Development to mediate the dispute. By 2008, the EU and Canada have not instituted their respective WTO and NATFA complaints mainly because the US has not been aggressively enforcing the extra-territorial provisions of the Helms-Burton Act and the Iran Sanctions Act.

¹⁶ The 1998 Agreement consists of the Understanding with Respect to Disciplines for the Strengthening of Investment Protection, and its four annexes (18 May 1998) [hereinafter 1998 Understanding]; the Understanding on Conflicting Requirements and the Transatlantic Partnership on Political Cooperation. The texts of the 1998 Understanding and Understanding on Conflicting Requirements, see Delegation of the European Commission to the United States, 'Guide to the EU-US Summit' (London: 18 May 1998) (on file with author).

¹⁷ Ibid.

¹⁸ Annex A addresses the establishment of a registry to administer claims for expropriated Cuban property in contravention of international law. The registry will provide relevant information concerning these claims for investors, claimants, and participating governments.

Specific Disciplines;¹⁹ Annex C, Definitions;²⁰ and Annex D, which is a letter from Sir Leon Brittan to US Secretary of State Madeleine Albright with the conclusions of the European Commission on behalf of the European Union based on information relating to the expropriation of properties concluding that 'most of these cases appear to be contrary to international law.'²¹ Both Understandings compose the 1998 Agreement. The 1998 Agreement is also accompanied by unilateral statements that set forth the conditions and terms of implementation.²² Although agreement was reached on an array of issues, the parties expressly stated that the 1998 Agreement constituted political commitments belonging to the realm of soft law, rather than binding legal obligations. As a result, the parties consider the agreement as merely conferring a moral obligation on the participants to use their best efforts to fulfill the objectives of the agreement, while creating no legal obligations as such. Accordingly, non-fulfillment of the principles in the agreement could not justify the use of legal sanctions.

Taken together, the two Understandings of the 1998 Agreement seek to establish: (1) a Transatlantic Partnership on Political Cooperation, which would promote the more effective attainment of shared goals through economic and political co-operation; and (2) a package relating to US sanctions laws, by which the United States would limit the impact of certain extra-territorial provisions on European and other third country companies and citizens. In return, the EU and Canada agreed to cease any further action in the WTO and NAFTA on the alleged US violations of its treaty obligations because of extra-territorial sanctions. It is important to note that this agreement has no legally binding effect and reflected the parties' aspirations and commitment to resolve the political impasse over extra-territorial US sanctions. The agreement does provide, however, a common acceptance by its signatories of a core set of principles that should be applied when the parties seek to resolve related conflicts and disputes. Indeed, these hortatory principles evidence a recognition on the part of the European Union of the concerns expressed by the US government over fundamental breaches of international law committed by Cuba in the areas of property confiscations and human rights abuses and, with respect to Iran and at the time Libya, support for international terrorism and the development of weapons of mass

¹⁹ The specific disciplines for Annex B contain additional guidance for the execution of arbitral awards and judicial decisions involving expropriated property and provide the elements for a determination of 'a record of repeated expropriation in contravention of international law.'

²⁰ Annex C defines 'covered transactions,' and other terms such as 'Government Commercial Assistance'.

²¹ Annex D.

²² For EU Unilateral statement; for US Unilateral statement.

destruction (nuclear, chemical and biological weapons) in breach of multilateral conventions.²³

The 1998 Agreement's First Understanding established the Transatlantic Partnership on Political Cooperation to strengthen political and economic co-operation on matters pertaining to peace, democracy and prosperity.²⁴ It also emphasised the importance of common approaches to address threats to international security and to breaches of fundamental norms of international law and emerging principles of state practice. Specifically, it addressed the contentious issues of extra-territoriality under the Helms-Burton and Iran/Libya Acts. The Understanding envisaged the exchange of information, analysis and early consultations to avoid tensions in transatlantic relations on issues that could threaten international stability and security, and to promote greater co-operation in formulating responses to such issues, whether diplomatic, political, or economic through the use of multilateral sanctions.

Specifically, the 1998 Agreement requires the parties to ensure that, *inter alia*, they will 'not seek or propose, and will resist, the passage of new economic sanctions legislation based on foreign policy grounds which is designed to make economic operations of the other behave in a manner similar to that required of its own economic operators.'²⁵ This provision was obviously insisted upon by the European Union to prevent enactment of further extra-territorial legislation, such as the Helms-Burton or Iran/Libya Acts. EU officials view this provision as obliging the President to 'resist' the adoption of legislation imposing economic sanctions for foreign policy purposes. Such resistance could entail active lobbying against new economic sanctions bills and even using the veto if necessary.

The Second Understanding reflects the desire of both parties to find a political compromise over the ongoing controversy surrounding extra-territorial sanctions. To demonstrate the issues underlying the conflict, the Europeans reiterated their position that the retroactivity of the contested Acts, their imposition of secondary boycotts and their extra-territorial effect violated international law. The EU expressed their primary objectives in enacting the agreement to be the neutralisation or repeal of extra-territorial US sanctions with respect to Cuba, Iran and Libya. Pursuant to the 1997 MOU, the US had already committed itself to maintain the suspension of Title III private actions under Helms-Burton 'during the remainder of the

²³ At the time, the US was mainly concerned that Iran and Libya were developing chemical and biological weapons in violation of the Convention on the Prohibition of the Development, Production, Stockpiling and Use of Chemical Weapons and on Their Destruction, 32 *ILM* 800 (1993).

²⁴ One of the principal aims was to reinforce the 'new Transatlantic Agenda' that had been adopted at the G7 Summit in Halifax, Nova Scotia in 1995.

²⁵ Transatlantic Partnership on Political Cooperation, para. 2(h).1.

President's term so long as the EU and other allies continued their stepped-up efforts to promote democracy in Cuba (1997 MOU).' The 1998 agreement states that the parties 'recalled' their pledge in the 1997 MOU to 'step up their efforts to develop agreed disciplines and principles for the strengthening of investment protection' in bilateral consultations.²⁶ Most important, the parties acknowledged in the 1997 MOU that the standard of protection governing expropriation and nationalisation embodied in international law should be respected by all states. In addition, the parties recognised in the 1997 MOU that the primary issue in the Cuban-US conflict to be the resolution of confiscated property claims, and that any future MAI disciplines:

should inhibit and deter the future acquisition of investments from any State which has expropriated or nationalized such investments in contravention of international law, and subsequent dealings in covered investments. Similarly, and in parallel, the EU and U.S. will work together to address and resolve through agreed principles the issue of conflicting jurisdictions, including issues affecting investors of another party because of their investments in third countries.²⁷

In addition, the US government, once it determined that the bilateral consultations mentioned above were completed and the European Union had adhered to the agreed disciplines and principles, committed itself to initiate consultations with Congress for the purpose of amending the Helms-Burton Act to provide the President with discretion to waive Title IV. Until such amendment becomes law, however, the State Department would continue to enforce Title IV.²⁸ EU efforts to persuade Congress to amend the Helms-Burton Act have failed.

Regarding the Iran/Libya Act, the 1997 MOU had referred to the common efforts made under the New Transatlantic Agenda to eliminate terrorism and inhibit the spread of weapons of mass destruction. Thus, the 1997 MOU recognised that the President would continue to implement the Iran/Libya Act but also noted that the United States welcomed the measures taken by the European Union on this subject. Although the Iran/Libya Act would stay in effect, the US indicated that it would consider granting country waivers (as provided in the Act) to EU member states under section 4(c) with regard to Iran and to EU companies under section 9(c) with regard to Libya, if EU states and their companies could demonstrate conclusively that their investments were not directly supporting Iran's development of weapons of mass destruc-

²⁶ The 1998 Understanding's preamble cites the 1997 MOU.

²⁷ 1997 Understanding, 36 *ILM* pp. 529–30.

²⁸ For instance, in 2000, the State Department issued an advisory letter under Title IV to the officers of Sol Melia, S.A., a Spanish-owned hotel firm, concerning its joint venture with the Cuban government involving confiscated Cuban property.

tion and Iran and Libya's support for international terrorism. The EU also agreed to suspend the WTO proceedings it had initiated but reserved the right to resume or to begin new proceedings, 'if action is taken against EU companies or individuals under Title III or Title IV of Helms-Burton or if the waivers under the Iran/Libya Act were not granted or withdrawn.'²⁹ Thus, while the US emphasised the reaffirmation of important principles of international law as reflected in the MAI and the development of co-operative efforts to address security threats to the international system, the Europeans demanded an exemption for their companies from the most controversial aspects of the Helms-Burton and the Iran/Libya Acts. By 2008, the US has only selectively enforced Title IV of Helms-Burton and the Iran Sanctions Act in cases where the foreign companies are engaged in persistent and substantial trade and investment with Cuba or Iran.

The 1998 Agreement builds on the foundation created by the 1997 MOU by including the disciplines and principles referred to in the Second Understanding with Respect to Disciplines for the Strengthening of Investment Protection. The parties agreed, as a matter of policy, to apply and uphold the disciplines and 'modalities' of the Second Understanding while continuing to negotiate the terms of its implementation into national law.³⁰ The EU unilateral statement asserts that once the parties agree on a joint proposal for implementation, it will reiterate its demands based on the 1997 MOU that the United States implement its commitments, namely, (1) amending Title III to provide the President with the authority to impose an indefinite suspension on Title III lawsuits, (2) congressional approval of waiver authority for Title IV to be exercised by the President; (3) no action to be taken against EU companies or individuals under the Iran/Libya Act; and (4) presidential waiver authority to be granted and exercised under the Iran/Libya Act. Only after these terms are met will the European Union adhere to the terms of the 1998 Understanding, i.e. not invoke a WTO dispute settlement proceeding against the United States.³¹ In contrast, the US maintains that it will continue enforcing Title IV of Helms-Burton so long as it remains mandatory under US law.

The EU also referred to the country waiver under section 4(c) of the Iran/Libya Act with respect to Iran and stated that 'it is axiomatic that infra-structural investment in the transport of oil and gas through Iran be carried

²⁹ See 36 *ILM* at p. 530.

³⁰ 1998 Understanding, paras. II(4), (5). The parties' negotiations over a joint proposal for implementing the 1997 and 1998 agreements were part of the MAI negotiations, but when MAI talks were suspended in 1999 so too were the parallel EU-US negotiations over implementation.

³¹ EU Unilateral Statement. It is important to note however that the EU has withdrawn the WTO complaint and Canada and Mexico have both withdrawn the NAFTA complaint.

out without impediment.³² US Undersecretary of State Stuart Eizenstat, while testifying before Congress, rejected this view by stating that it was not a section 4(c) waiver that would 'eliminate any further application of [the Iran/Libya Act] to the [EU].'³³ To the contrary, Eizenstat declared that a waiver for third country investment in an Iranian energy project must be obtained under section 9(c), and that such waivers would not be granted if a pipeline is built across Iran because it 'would give Iran a chokehold over the economic and political developments in the Caucasus and Central Asian states (Ibid.).'

Regarding the protection of private property, the Second Understanding is an essential part of the 1998 Agreement and confirms the parties' intention of jointly proposing the agreed disciplines regarding foreign-owned property interests and of applying these disciplines, as well as the 'modalities' contained in the Understanding, as a matter of policy in any future negotiation over a MAI. The Understanding distinguishes between general disciplines and specific disciplines. Whilst the general disciplines reflect the positions of the parties on how they perceive the international protection of property rights, the specific disciplines are meant to offer the EU and US views on the most appropriate regime to apply to properties expropriated in violation of international law. Accordingly, the participants committed themselves to (1) strengthen the international protection of property rights in the context of investment protection; (2) take joint action to enforce the observance of international law standards on expropriation, emphasising the undesirability of investment in property expropriated in violation of international law;³⁴ (3) establish a registry for the filing of all alleged claims

³² EU Unilateral Statement, paras. II(3).

³³ *Capitol Hill Appearance*, Fed. News Service (3 June, 1998), Hearing of the House Committee on International Relations.

³⁴ The parties' adopted the 'Hull formula' in recognition of a state's obligation under international law to pay full-market value compensation when it expropriates foreign-owned private property. In fact, the proposed MAI had incorporated the 'Hull formula' in its provisions covering expropriation and compensation. It states:

- 2.1 A Contracting Party shall not expropriate or nationalise directly or indirectly an investment in its territory of an investor of another Contracting Party or take any measure or measures having equivalent effect except: (a) for a purpose which is in the public interest, (b) on a non-discriminatory basis, (c) in accordance with due process of law, and (d) accompanied by payment of prompt, adequate and effective compensation in accordance with Article 2.2 to 2.5 below.
- 2.2 Compensation shall be paid without delay.
- 2.3 Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation occurred. The fair market value shall not reflect any change in value occurring because the expropriation had become publicly known at an earlier date.

of expropriated properties in violation of international law and measures discouraging certain transactions in such expropriated properties.³⁵ The parties agreed that a 'covered transaction' means any future transaction related to property expropriated by a state other than a party to the agreement only if it gives rise to:

- (a) a direct ownership interest in such a property (e.g. purchase of expropriated property, obtaining mineral rights (to the extent that these were included in the expropriated property));
- (b) control of all or part of an expropriated property (e.g. lease of the expropriated property or a management or development contract);
- (c) the acquisition of effective control or a determining interest in an equity owning or controlling expropriated property under (a) or (b) insofar as the property constitutes a significant proportion of the assets of that entity or the expropriated property is a fundamental element of the transaction.³⁶

Moreover, when properties are expropriated in violation of international law, certain specific disciplines are to be applied. The Understanding requires the parties to take action in the form of (a) joint or co-ordinated diplomatic representations to the expropriating state; (b) denial of government support for certain transactions in expropriated properties; (c) denial of government commercial assistance for such transactions in expropriated properties; and (d) publication of a list of expropriated properties and issuance of public statements discouraging covered transactions in those properties. Moreover, if one of the parties believes that a record of repeated expropriations in violation of international law has been established in the territory of a non-participating country, the party is to inform the other party of this fact so that the latter may protect its investors. When the conditions of the Understanding are met, the disciplines are to apply simultaneously (para. II. 4).

The terms of the Second Understanding provide for retroactive application from 18th May 1998 (para. I.C). It will not apply, however, to (1) covered

2.4 Compensation shall be fully realisable and freely transferable.

2.5 Compensation shall include commercial interest for the currency of payment from expropriation date.

³⁵ 1998 Agreement, Second Understanding, para. I.A. To determine whether a particular expropriation violates international law, Annex D suggests possible modes of dispute resolution: (1) international arbitration or the courts of the expropriating state; (2) according to 'modalities to be elaborated among the participants or under the MAI' that the claim is well-founded and that judicial relief has been unjustly denied; or (3) where, on the request of a participant which considers there has been a record of repeated illegal expropriations, evidence provided to the other participant is duly evaluated and accepted.

³⁶ See 1998 Agreement, Second Understanding, para. I.B.

transactions relating to an expropriated property or to a right in expropriated property that an investor of one of the participating countries acquired from the expropriating state prior to 18th May 1998, or (2) to covered transactions in expropriated property by a party's other investors who subsequently acquired that property or property right. In other words, the Understanding does not apply to investors who are nationals of countries that are parties to the agreement who, prior to 18th May 1998, owned a right in property expropriated in violation of international law. Similarly, the disciplines of the Understanding would not apply to the acquisition of a right in expropriated property by any other investor who is a national of a country that is party to the agreement who acquires such right after 18th May 1998 from an investor who is also a national of a participating country. However, all investors are subject to the disciplines of the agreement if they acquire after 18th May 1998 a right in expropriated Cuban property from any person who is not a national of a party to the 1998 Agreement. The disciplines would also apply to an investor of a party to the agreement who already owns a right to expropriated property if that investor seeks, after 18th May 1998, to acquire a right in other expropriated property or to extend, renew or upgrade a current right in expropriated property (*ibid.*).

The objective of discouraging transactions in confiscated Cuban property demonstrates the importance under the Agreement of strengthening foreign investment protection, which *a fortiori* promotes the purposes and principles of the Helms-Burton Act. Moreover, after Libya was certified as complying with Security Council resolutions 748 and 883 and was declared by the US in 2004 to be no longer a state sponsor of terrorism, the Iran/Libya Sanctions Act was amended by Congress to become the Iran Sanctions Act. Presently, the US continues to promote the objectives of the Iran Sanctions Act by enforcing sanctions against third country companies whose home states fail to demonstrate to the US that the investment in question does not support Iran's development of weapons of mass destruction (WMD) and support for international terrorism. Indeed, the terms of the Second Understanding are similar to the conditions that governed the extra-territorial application of US sanctions against Canada under the EisenhowerDiefenbaker Agreement. Essentially, the US will not grant a waiver under section 9(c) of the Iran/Libya Act unless it is satisfied by the representations of home-state governments that the investments of their nationals do not support international terrorism and the development of weapons of mass destruction.

The 1998 Agreement accomplished most of the stated objectives of US sanctions laws, namely, the establishment of a multilateral framework composed of most of the major developed countries that significantly restricts their investment in confiscated Cuban property and in the Iranian and Libyan energy sectors and WMD projects. With respect to extra-territorial sanctions, the US has only committed itself to avoid or minimise conflicts

by 'having regard to relevant principles of international law,' and taking 'into account the sovereignty and legitimate...law enforcement...interests of other...parties.'³⁷ The EU has accepted extremely precise disciplines on investments, while receiving in exchange only vague commitments by the US not to violate international law and to waive the application of extra-territorial sanctions only if EU states can demonstrate that the investments of their nationals in Cuba, Iran and Libya do not violate the restrictions of US sanctions policy.

By entering the 1998 Agreement, the EU, Canada, and Japan agreed to restrict their trade and investment with Cuba, Iran and Libya so as to reaffirm the right of foreign investors to be compensated for the loss of expropriated property and to deter the development of WMD and to combat international terrorism. In fact, the agreement appears to confirm the US policy of using extra-territorial sanctions to pressure third country states to adopt similar economic controls against target states in order to uphold international legal norms and promote related security objectives.³⁸ The support by the US for the 1998 mutual assistance agreement was reflected in Undersecretary of State Eizenstat's testimony before Congress in which he declared that the agreed disciplines represent 'a historic breakthrough' that 'builds on the Libertad [Helms-Burton] Act and represents an enormous step forward in protecting property rights of U.S. investors anywhere abroad.' Further, he declared 'for the first time, we have established multilateral disciplines among major capital exporting countries to inhibit and deter investment in properties which have been expropriated inconsistent with international law' (House of Representatives, 1998).

Conclusion

Although the 1998 Agreement is not legally binding, it reaffirms important principles and rules of international law and provides the basis for an international regime of standards and hortatory principles that govern how economic sanctions should be used against third country persons in order to uphold international norms and achieve security objectives. The EU-US Agreement (also signed by the other G7 states) provided a principled framework in which the major economic powers committed themselves to adopt policies that discouraged investment in confiscated Cuban property

³⁷ See Draft Agreement appended to Second Understanding.

³⁸ Indeed, this view was expressed by the then Minister of Foreign Affairs for Belgium, Eric Derycke, who critically observed that the 'EU was compelled to accept extremely precise disciplines on investment, ... while receiving nothing but a simple commitment from the American side to maintain the exceptions for European companies'. Public Hearing on Extra-territorial Laws as Unilateral Sanctions, Comm. External Economic Relations, European Parliament, June 24, 1998.

and curtailed investments in Iran and Libya. The combined economic sanctions of the EU and the US against Libya was determinative in persuading Libya in 2003 to disavow and dismantle its weapons of mass destruction programme and cease supporting international terrorism. Indeed, the 1997 and 1998 agreements appear to be a vindication of the US policy of extra-territorial economic sanctions, even though many nations and observers continue to criticize such sanctions as contrary to international law and ineffective in accomplishing their stated objectives. Under the agreements, the US undertakes to use its best efforts to waive the application of such sanctions to all persons of countries that have adopted the principles of the agreements and have demonstrated compliance. In the meantime, extra-territorial US sanctions will stay in force against third country persons who continue such practices that are viewed by the US as a violation of the purpose and terms of both agreements. As result, US policymakers consider the 1997 and 1998 agreements to be a victory for the assertive use of extra-territorial sanctions in upholding rules of international law and promoting emerging regimes of political stability in the international system.³⁹

On the other hand, EU policymakers argue that their adoption of Regulation 2271/96 and the various EU member state blocking statutes were defiant gestures against extra-territorial US authority that forced the US to the bargaining table to negotiate the MOU. Moreover, EU Commission officials have observed that the MOU has resulted in the US following a more 'light touch' approach in the application of extra-territorial sanctions under the Cuban embargo and the Iran Sanctions Act which has resulted in a sanctions truce between the EU and US since 1998.⁴⁰ However, signs that the truce is dissolving occurred in 2004 when the US Treasury and the Board of Governors of the Federal Reserve System announced that they were imposing an 80 million US\$ penalty on ABN AMRO bank of the Netherlands for its involvement in facilitating US dollar transactions for Iranian state agencies and businesses. The severity of the penalty – even for a large multinational bank – appears to signal a return of US surveillance of EU firms' business ties with US targeted states such as Iran.⁴¹ Although the 1998 MOU

³⁹ See Secretary of State Madeleine K. Albright, 'Statement on U.S.-E.U. Understanding on Expropriated Property' (London: May 18, 1998)(visited Nov. 2, 1998) <www.secretary.state.gov/www/statements/index.html>.

⁴⁰ Oral evidence of Mr. Karl Kovanda and Mr. Albert Straver, European Commission, House of Lords Select Committee on Economic Affairs, 17 October 2006.

⁴¹ Following the \$80 million penalty against ABN AMRO, the UN Security Council approved Resolution 1737 in March 2007 that imposes financial sanctions against Iran with particular focus on Iranian state agencies, the Iranian Bank Sepah and its overseas branches and subsidiaries and designated Iranian military officials and certain religious leaders allegedly involved in terrorism. The Resolution was passed in response to Iran's defiance of Security Council resolutions demanding that it cease enriching uranium at Iranian nuclear facilities.

appears to have been a useful short-term measure to defuse some of the tension between the US and European countries over unilateral US sanctions, a more effective multilateral framework may now be needed to mediate the differences between the sanctions policies of the major G7 countries and their application under the UN sanctions regime against states such as Iran and North Korea and non-state actors that support international terrorism.

10

Extending Economic Sanctions: the Financial War on Terror

When the U.S. is confronted with a threat that is unreceptive to diplomatic outreach and when military action is not an option, [financial] tools are often the best authorities available to exert pressure and to wield a tangible impact.

John Snow, former US Treasury Secretary,¹ 7 May 2006

I The shift to targeted financial sanctions

Targeted financial sanctions have become the policy of choice for developed countries that seek to limit collateral economic and social costs that broader economic sanctions programmes cause. Financial sanctions usually take the form of asset freezes, blocking orders, and restrictions on foreign exchange and fund transfers. They can be targeted specifically against foreign states, foreign institutions, and foreign transactions and accounts. They can result in administrative, civil and criminal liability and penalties against targeted business entities and individuals. Financial sanctions have generally been used as part of broader economic sanctions programmes and have attracted much attention in recent years as an alternative economic sanctions weapon that can avoid the widespread social costs and human misery that arose from the UN sanctions programme against Iraq.

Since the early 1990s, US sanctions have become more targeted and effective in isolating certain foreign governments and in targeting the assets of some international terrorist organisations and drug traffickers. Following 11th September 2001, President Bush signed Executive Order 13224 that significantly increased the scope of US financial sanctions against international terrorists and terrorist organisations. Today, US financial sanctions

¹ *The Financial Times*, 'US seeks de facto financial sanctions on Iran', Edward Alden and Caroline Daniel (7 May 2006).

are targeted against an array of alleged international terrorists and terrorist-supporting governments. Moreover, the US financial sanctions that apply to Cuba, Iran and North Korea also restrict certain transactions and financial assistance by third country businesses and financial firms with these targeted states or their nationals.

In addition, under the USA Patriot Act, the US has adopted financial sanctions to target foreign jurisdictions, foreign financial institutions, and foreign transactions and accounts that are allegedly involved in money-laundering or supporting international terrorism or states that support the development of weapons of mass destruction. Although the US has attempted to coordinate these financial sanctions measures through multilateral bodies (e.g. the Financial Action Task Force and Security Council Sanctions Committees), US financial sanctions are often taken on a unilateral basis without approval or support from other governments. Recent examples include the unilateral sanctions against Iran, Cuba, Syria, and North Korea. Moreover, the US often maintains unilateral financial sanctions against alleged terrorists in other countries, even when the relevant UN Security Council Sanctions Committee has not approved their application. This raises serious legal and regulatory problems for EU policymakers and other European-based businesses that do business with the United States.

This chapter examines the use of financial sanctions that target non-state actors, primarily terrorists and terrorist organisations and related threats from money launderers. It does so by analysing the evolving patterns of terrorist financing through corporate and other business entities and related trading practices. It then examines the main US legislation that seeks to interdict terrorist financing and the targeted states which participate in it.

II The changing nature of terrorist financing and financial crime

Although there are numerous sources for the funding of terrorism, the particular means for the financing of terrorism varies from group to group. A US Treasury Department official testified that most terrorist groups in Europe, East Asia, and Latin America derive their financial sources from criminal activities such as extortion, kidnapping, narcotics trafficking, counterfeiting and fraud to support their terrorist activities (Zarate, 2002). In the Middle East, some terrorist groups utilize commercial enterprises or funds derived from charitable organisations, while others rely on state sponsors for funding. For example, charitable donations are considered a major source of terrorist funding. Indeed, investigation and analysis by intelligence agencies have produced information indicating that terrorist organizations utilize charities to raise money for terrorist activities. For example, charitable donations to non-governmental

organisations are commingled and then diverted to organisations that support terrorism. Fundraising often involves activities to solicit money in many countries, including the United States, Canada, and in the EU states.

Moreover, terrorist groups often use companies and businesses to generate resources for terrorist activity. Indeed, terrorist groups often use companies and other commercial enterprises as vehicles through which to transfer funds in what is called a layering process. For example, the US Treasury Department's Office of Foreign Assets Control and the EU Council of Ministers have designated several companies, such as the Al-Barakaat companies, as fronts for terrorist organisations whose assets the US government requires to be frozen.²

Emerging trends in terrorist financing

The recent work of national regulators acting with the support of international bodies has uncovered a global mosaic of terrorist financing networks involving the movement of suspected terrorist funds. The motive behind crimes that support terrorist groups is different from that of other criminal organisations or networks. Unlike drug traffickers and organised crime groups, which seek financial gain as the primary goal, terrorist groups usually have primary goals that are of a more political nature. For example, terrorist groups often seek as a primary objective to achieve publicity for a particular political or social cause, the dissemination of an ideology, the destruction of a society or regime, and simply spawning terror and intimidation.

Terrorist financing therefore seeks different overall objectives as compared to classic money-laundering. In cases of money-laundering, the proceeds of illicit activity are laundered or layered in order to legitimise the source of the proceeds, and the ultimate goal is most often the attainment of more money. The source of funds or finance are often legitimate as in the case of charitable donations or profits from store-front businesses and the ultimate goal is not the attainment of more funds, but more of a political nature that quite often involves violence, coercion and fear. It is a difficult endeavour to discover the sources and methods of terrorist financing. The complexity derives, in part, from the sophistication of individuals who seek to conceal their activities. It is also difficult to attribute ownership or control of terrorist assets and funds to the individuals or entities who are involved in terrorist activity.

Nevertheless, similarities exist in the way that international terrorist groups and criminal enterprises extend their commercial reach by moving and concealing the transfer of financial assets. International terrorist groups need more money to attract, support, and retain adherents throughout the world as well as to secure loyalty of other groups that share similar objectives. The covert nature of such operations necessitates that complex schemes be devised

² Kadi and Al Barakaat Yassin Abdullah International Foundation of Council of European Union. C-402/05 and C-415/05P (2008).

to raise, collect, and distribute money to operatives and other supporters who assist in various operations. An essential element of any terrorist operation therefore is its ability to move money on a global basis, and it is precisely this need that makes terrorist funds vulnerable to detection if adequate safeguards have been adopted by regulators and market participants.

Corporate structures and financial dealings

The events of 11th September have demonstrated how terrorists and economic criminals can evade national regulatory controls by using corporate structures and sophisticated financial transactions involving multiple jurisdictions to execute and finance their operations. In the realm of company law and financial regulation, it should be recognised that traditional legal techniques for regulating companies and financial firms have proved insufficient in addressing the role of third party facilitators who provide material support for organised crime groups and trans-national terrorist organizations. Most law enforcement authorities and financial regulators are in agreement that an effective way to interdict terrorist operations is to create civil or criminal liability for third party financial firms, companies and professionals who advise and provide material support to terrorist organisations. In the area of economic crime, this has become the preferred regulatory approach in limiting money-laundering activity. The rationale is that by blocking third party financial support, it will be extremely difficult for terrorist groups to generate resources to finance their activities.

Many companies and business entities have operated as cloaks for terrorist groups, and serve as vehicles for the transfer and 'layering' of funds to avoid detection. These apparently legitimate business enterprises often establish an array of subsidiaries as 'fronts' in different jurisdictions and operate within a corporate group structure to conceal a variety of criminal and terrorist activities. For instance, OFAC has designated, pursuant to the September 2001 Executive Order, the Al-Barakaat companies as fronts for international terrorist organizations.³

Another type of financing occurs in small retail businesses that deal exclusively in cash. These enterprises are ideal for laundering the proceeds from a variety of criminal activities and provide retail outlets for stolen merchandise. They also serve as a cover for informal remitters, such as hawaldars. Another source of terrorist financing arises from fraud schemes that provide illegal profits for terrorist operations. For example, this occurred in 2001 in the United States, where the FBI and the US Bureau of Alcohol, Tobacco, and Firearms and the Immigration and Naturalization Service discovered a contraband cigarette trafficking and fraud scheme involving

³ See Appendix to Exec. Order 12334 (23 Sept. 2001), Office of Foreign Assets Control website www.treas.ofac.gov.

nearly a dozen Lebanese individuals, who were later found to be involved in a military procurement programme that was designed to obtain and send dual use products and technology to Hezbollah.

Trade mispricing

Terrorist groups may utilize international trade in a manner that disguises their funding sources. For instance, terrorist front companies might manipulate the price of merchandise by undervaluing or overvaluing, or they might use double invoicing or fabricate the documents of shipping certain products. The US government relies on various commercial databases in the Customs Service to identify trends and anomalies in particular companies and industries. The Customs Service Office of Strategic Trade and Intelligence examined data involving the export of honey to Middle East countries and it identified anomalies in the packing weight, shipping weight and the reported value of the shipped honey. These facts might indicate trade-based money-laundering or terrorist financing. Moreover, on 12th October 2001, the OFAC identified two honey companies as fronts for terrorist funding to Al-Qaida.⁴

Although the regulatory and enforcement mechanisms discussed above may achieve some level of success in ridding the formal banking and commercial sectors of terrorist financing, it should also be emphasised that such stringent measures may likely result in the movement of most terrorist financial sources into the informal financial sector (i.e. underground banking system). Indeed, such informal financial systems will pose the major challenge for regulators seeking to restrict and interdict transactions involving terrorist groups.

Informal methods of money movement – underground banking systems

Informal systems of moving money may be used by Al-Qaida and other terrorist groups operating in developing countries to support related organisations, sleeper cells, or individuals. Of these systems, the hawala system has attracted the most attention. Hawalas operate on trust and informal relationships, which emphasise anonymity, no documents or paper trail, and complete avoidance of any formal system of government regulation. The attraction of such a system is that operators can move money across borders without actually physically moving it by assuring that the account will be settled by money or material goods returned in a future reverse transaction. Hawalas have been widely used in the Middle East and South Asia for

⁴ Ibid.

centuries, and the US government alleges that Al-Qaida and other terrorist organisations are exploiting the hawala system today.

As mentioned above, the OFAC blocked on 7th November 2001 the assets of the Al-Barakaat corporate group, a global network of money remitting companies, that were held by US-persons or US-controlled persons throughout the world. The grounds for the US freeze order was that Al-Barakaat was controlled by Usama bin Laden to support terrorist activities. Although the operations of Al-Barakaat in the US relied on traditional banking systems, it operated at the international level as a hawala network that allowed funds to be channelled into Somalia through Dubai. According to OFAC, this hawala network was used not only to fund Al-Qaida and other bin Laden organisations, but also provided logistical support for his network.⁵ The OFAC claims that its freeze and blocking orders have put Al-Barakaat out of business, and therefore it can no longer serve as a global money transmission network for terrorist groups. Other experts assert however that money transmission by Al-Qaida and other terrorist groups takes place through other alternative remittance systems, and these systems (including hawala) completely circumvent existing strategies used by financial regulators at present to curtail terrorist financing.

Despite success in some areas, US and other regulatory authorities have not been able to penetrate and monitor many non-traditional remittance systems, such as hawala. In an effort to broaden its understanding of alternative remittance systems, the US Treasury's FinCen formed an Alternative Remittance Branch that is responsible for the analysis of bank data and other information to identify mechanisms and systems used by criminal organisations to transfer funds in support of domestic and international terrorism. This regulatory approach intends to focus on *Informal Value Transfer Systems* (IVTS), such as hawala, hundi, and other Asian and South American systems as an important but inadequately understood methodology for fund movement. Regulators should also direct attention to developing key indicators of IVTS use by criminal and terrorist enterprises that would support law enforcement initiatives to combat terrorist activities. This would also involve identifying the policy implications for law enforcement and regulators should they acquire the knowledge and capability to monitor and interdict terrorist financing in informal value transfer systems. The development of an effective international regulatory regime to restrict terrorist financing will fail if its primary focus remains on the formal financial sector. Successful interdiction requires a comprehensive approach that operates on the assumption that most terrorist financing is facilitated through hawala-type networks and other informal value transfer systems. To date, international organisations and leading states (i.e. the US) have not

⁵ It should be noted that Al-Barakaat denies any involvement with bin Laden or with any other terrorist groups (Alden & Turner, 2001).

succeeded in developing adequate regulatory approaches in this area. Success in the war against international terrorism requires it.

In addition few countries utilise comprehensive legislative and regulatory approaches that seek to control the global activities of companies and firms that are involved in terrorism. The financing of international terrorism is of major concern and there is a growing recognition that the global dimension of terrorism must be addressed at the international level, and that a significant revision of national company laws and financial regulation must be undertaken to ensure that those who facilitate or provide material support, either direct or indirect, are held accountable through civil sanctions and even criminal penalties.

The problem is not simply a matter of terrorists setting up front organisations and companies in accommodating jurisdictions that enable them to create a veil of legitimacy behind which they can conduct their illicit activities, but also concerns companies and financial firms indirectly facilitating terrorists acts by providing commercial services or professional advice to organisations or individuals operating in one country, but who are planning to undertake criminal or terrorists acts in other countries. Indeed, the global dimension of terrorism and its financing exposes the limitations of most national legal systems in providing effective legal principles on which an effective regulatory regime can be based. By contrast, some legal systems – the US in particular – have established far-reaching principles of third party liability and extra-territorial jurisdiction that address some of the technical legal problems associated with developing an effective international strategy to combat terrorism and financial crime.

III Financial sanctions and extra-territorial enforcement

The implementation of an effective global surveillance and enforcement strategy requires more harmonisation of financial regulatory practices by national authorities. This would be difficult because some states are more committed to exerting control over terrorist financing and sanctions busting activity than others due to differing national priorities based on different social and cultural attitudes about what constitutes ‘terrorism’ or the general desirability of imposing economic and financial sanctions on states and their nationals. Indeed, because many states have differing notions over what constitutes acceptable or even criminal behaviour, it is very difficult to adopt and implement an effective transnational regime to combat international terrorism and economic crime. Consequently, some states have adopted aggressive unilateral measures that have extra-territorial effect in combating international organised crime.

For example, the United States was the first country to enact strict anti-money-laundering legislation with the Money Laundering Control Act

of 1986 (MLCA).⁶ Since that time, more comprehensive legislation has been enacted including the Anti-Drug Abuse Act of 1990, the Annunzio-Wiley Anti-Money Laundering Act of 1992,⁷ the Money Laundering Suppression Act of 1994, and the USA Patriot Act 2001.

The 1986 MLCA has broad extra-territorial effect, requiring non-US banks with offices in the US to submit financial disclosure reports on the operations of their overseas branches (Dept. of Justice Handbook, 1987).⁸ Specifically, section 1956 (f) imposes extra-territorial jurisdiction over a financial institution that receives or disburses \$10,000 or more in a single transaction and the conduct is either by a US national or occurs in part in the United States. Even if the bank has no US operations, but keeps dollar accounts with US financial institutions, it may be required under certain circumstances to report suspicious transfers of US dollars. In 1988, the US government froze the US assets of Banco de Occidente, a Colombian bank with no operations based in the US, because it had facilitated large transactions in US dollars involving the international narcotics trade. Indeed, the Department of Justice has interpreted this section as conferring subject matter jurisdiction over such transactions undertaken by foreign institutions which participate in conduct occurring in whole or in part in the United States (Ibid., p. 14).

The US adopted express regulatory provisions based on existing emergency statutes in the 1990s to combat narcotics trafficking and terrorism. In 1995 when President Clinton, acting pursuant to authority granted in the International Emergency Economic Powers Act, issued Executive Order 12978 that imposed economic sanctions against 'Specially-Designated Narcotics Traffickers' (SDNTs) in Colombia for undertaking practices outside US territory that would be defined as drug trafficking or money-laundering if committed within the US.⁹ These regulatory controls provided broad authority for the US President who delegates authority to the US Treasury to designate foreign narcotics traffickers and terrorists and their supporters so that they can be placed on blacklists and have their assets blocked or frozen indefinitely until they can satisfy US authorities that they are not involved

⁶ 18 U.S.C. § 1956 (2006).

⁷ See 28 U.S.C. § 1355(b)(2006).

⁸ See 18 U.S.C. § 1956 (f) (2006). The Department of Justice interprets the broad language of § 1956 (f) as imposing jurisdiction over foreign institutions that do business in the United States.

⁹ See Exec. Ord. 12978. The regulations that implemented the Order were promulgated by the Department of Treasury, acting through its Office of Foreign Assets Control, and entitled the Narcotics Trafficking Sanctions Regulations, 31 C.F.R. § 536.100 *et seq.* There are over 500 Colombians listed as SDNTs. OFAC also administers foreign assets control regulations against specially-designated terrorist organisations. See Terrorism List Government Sanctions Regulations, 31 C.F.R. §596.100 *et seq.*; Terrorism Sanctions Regulations, 31 C.F.R. § 595; and Foreign Terrorist Organizations Sanctions Regulations, 31 C.F.R. § 597.

in the activity in question. The blocking orders also apply to all supporters and advisers and business entities owned or control by these 'blacklisted' persons.

The sanctions also imposed extra-territorial jurisdiction based on the nationality principle by requiring all US persons and US-controlled persons abroad, including financial institutions and businesses, to block the assets and refuse transactions with Colombian SDNTs.¹⁰ In 1999, President Clinton signed into law the Foreign Narcotics Kingpin Designation Act that imposed the same strict economic sanctions on major drug traffickers and money launderers who operate anywhere in the world.¹¹ Under the Kingpin Act, 'Significant Foreign Narcotics Traffickers' (SFNTs) are defined as 'any foreign person who plays a significant role in international narcotics trafficking, that the President has determined to be appropriate for sanctions ..., and that the President has publicly identified.'¹² A controversial provision imposes extra-territorial jurisdiction by targeting assets that are owned or controlled by a 'foreign person' whom the US determines is 'providing goods or services in support of' the international narcotics trafficking activities of a SFNT.¹³ The legal basis for such extra-territorial jurisdiction appears to be the protective principle, as the Act's preamble states: 'the activities of international drug traffickers and their organisations have created a "national emergency that threatens the (U.S.) national security, foreign policy, and economy."' ¹⁴ It also states that because of the 'successful' application of economic sanctions to Colombian drug cartels, 'Congress believes similar authorities should be applied worldwide.'¹⁵

US economic sanctions policy with respect to international terrorism and narcotics trafficking is premised on the notion that the growth and extent of international terrorism and economic crime have necessitated an extra-territorial strategy that should be adopted by all states.¹⁶ This policy approach has been largely accepted by member states of the Organisation

¹⁰ 31 C.F.R. § 536.317.

¹¹ Foreign Narcotics Kingpin Designation Act, Pub. L. 106120 (Dec. 3, 1999). The US Economic Espionage Act of 1996 imposes extra-territorial jurisdiction on US-controlled foreign companies that are involved in the unauthorised transfer of proprietary information to non-US persons or entities, even though such conduct may occur in a foreign territory. Economic Espionage Act of 1996, Pub. L. 104-294 (1996). It also creates civil and criminal remedies against non-US-controlled persons who assist, facilitate or procure extra-territorial violations of the Act.

¹² Pub. L. 106120, § 302 (b).

¹³ S. 303(a)(1).

¹⁴ Preamble.

¹⁵ *Ibid.*

¹⁶ See discussion in Chapter 4.

of Economic Cooperation and Development and the Financial Action Task Force (FATF) that has required its 30 member states to adopt extra-territorial anti-money-laundering and terrorist financing measures. For instance, FATF Recommendation requires FATF member states to require the foreign branches and offices of their home-state financial institutions to adopt customer identification and suspicious transaction reporting rules.¹⁷ Moreover, extra-territorial jurisdiction has been accepted in the European Money Laundering Directives. For instance, the German Money Laundering Act now imposes duties on all relevant German institutions in respect of their overseas branches, even if they are outside the European Community.¹⁸ Similarly, British criminal legislation in the area of financial crime, terrorism and money-laundering expressly imposes extra-territorial jurisdiction in certain situations.¹⁹ In addition, section 8 of the Financial Services and Markets Act gives the Financial Services Authority jurisdiction over a regulated activity, even when it is not carried out in the United Kingdom or where clients or counterparties are located abroad, if the activity is conducted by a person whose head office or principal place of business is in the UK.²⁰

IV The Patriot Act – and regulatory controls to combat terrorist financing

The recent enactment of Title III of the USA Patriot Act, entitled the 'International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001' seeks to address this regulatory gap that has allowed those who finance terrorism and money-laundering to escape regulatory surveillance. The Act subjects banks, securities dealers, insurers and a host of other companies and professionals to increasingly stringent (and some

¹⁷ Directorate for Financial, Fiscal and Enterprise Affairs, Organisation for Economic Cooperation and Development, Financial Action Task Force on Money Laundering, IIB (1996), Recommendation 20.

¹⁸ The same duty is imposed on an enterprise incorporated abroad and independent from the German company but which is unified with the latter in the sense that they come under a common management.

¹⁹ Criminal Justice Act 1993, s. 93A. Section 93A amended section 102(1) of the Criminal Justice Act 1988 to state: "Criminal conduct" means conduct which constitutes an offence to which this part of this Act applies or would constitute such an offence if it had occurred in England and Wales and Scotland.' See also, Suppression of Terrorism Act 1978 c. 26. s 4(3)(giving extra-territorial effect outside the EU over any act that would be defined as a terrorist offence if committed in a EC member state).

²⁰ Financial Services and Markets Act, s. 8 and Draft Explanatory Notes on the Draft Bill (HM Treasury July 1998). Moreover, section 6(a) defines 'Offence' as 'an act or omission which would be an offence if it had taken place in the United Kingdom'.

might say draconian) controls directed against money-laundering and the financing of terrorist activity. Title III of the Patriot Act, extends the extra-territorial jurisdiction of the US Money Laundering Control Act of 1986 to cover the activities of foreign banks and firms that seek to utilise the US financial system to launder the proceeds of crime or to provide financial support for individuals and organisations involved in terrorism. In addition to providing US law enforcement authorities with vast new powers of surveillance and investigation, Title III of the Act contains new anti-money-laundering requirements and record-keeping and due diligence requirements that apply not only to financial firms but also to an array of other companies, including insurers, jewellers, car dealers and travel agents. The Patriot Act is the most important legislative instrument designed to achieve the policy objective of interdicting the financing of terrorism by both state and non-state actors. It does so by threatening to terminate a foreign state, business entity or person's access to the US dollar payment system and by potentially imposing civil and criminal liability on third party intermediaries based in foreign countries in order to dissuade them from doing business with terrorists, economic criminals and their advisers and supporters. Some of its main provisions will now be discussed.

An analysis of the Patriot Act

Section 311 provides the Treasury Secretary discretionary authority to impose one or more of five new 'special measures against foreign jurisdictions', foreign financial institutions, transactions involving such jurisdictions or institutions, or one or more types of accounts (including foreign accounts), that the Secretary determines to pose a 'primary money laundering concern' to the United States. The special measures include: (1) requiring additional record-keeping or reporting for particular transactions; (2) requiring identification of the foreign beneficial owners of accounts at US financial institutions; (3) requiring foreign banks to identify any of its customers who use (i.e. transfer of funds) an inter-bank payable through account opened by that foreign bank at a US bank; (4) requiring foreign banks to identify any of its customers who use an interbank correspondent account opened by that foreign bank at a US bank; and (5) after consultation with the Federal Reserve Board, the Secretary of State and Attorney General, to restrict or prohibit the opening or maintaining of certain interbank correspondent or payable-through accounts. The Treasury Department has issued most of the regulations regarding record-keeping and disclosure requirements.

Although foreign banks will not have to disclose such information directly to US authorities, US financial institutions will be required to collect

this information from foreign banks and if necessary to report this information to US regulatory authorities. The objective of these measures is to establish enhanced due diligence and recordkeeping requirements for foreign banks that hold private banking accounts with US financial institutions. The effect of the legislation will be to require foreign persons (business entities and individuals) who are the owners or beneficial owners of private banking accounts with a foreign bank that also maintains certain accounts with a US bank to disclose the nature of its wealth or commercial affairs with its foreign banker. The US bank will then collect this material and make it available for inspection by US authorities. These requirements will apply only to foreign banks operating under a licence from one of the following jurisdictions: (1) an offshore jurisdiction that has not complied with recognised international standards, (2) any other jurisdiction designated by the Financial Action Task Force as having failed to comply with its minimum international standards,²¹ or a jurisdiction or financial institution or other person that is unilaterally designated by the US Treasury as being of special money laundering concern.

If a foreign bank decides that it wants to opt out of these US regulatory controls, it must terminate all its correspondent, interbank and other accounts with US financial institutions. However, this will be a difficult option for many foreign banks that derive a significant amount of their business from transfers and transactions involving the US interbank payment system. Indeed, the international reach of the US banking system is demonstrated in part by the need of most non-US financial institutions to have access to US currency via a US bank in order to participate in the foreign exchange markets.²² This type of link to the US euro-dollar market will attract extra-territorial jurisdiction for a foreign bank under the Patriot Act. It remains to be seen whether the benefits for a foreign bank of maintaining interbank payment links with US financial institutions exceeds the costs (including lost business) of complying with the new legislation. The legislation has been in force since 2002 and there has been no appreciable decline in the willingness of foreign banks and central banks to hold US dollars assets or liabilities.²³

²¹ This would be countries or territories that are placed on the so-called FATF list of non-cooperative countries and territories (NCCTs). As of June 2007, no countries or jurisdictions are designated on the FATF NCCT list. In 2005, Nigeria and Nauru were removed from the list. See FATF, Annual Review of Non-cooperative Countries and Territories 2005/2006 (23 June 2006). Myanmar (Burma) was removed from the NCCT list in 2006.

²² See Tables 2.1 & 2.2 in chapter 2 showing the high level of US dollar assets owned by foreign banks and foreign financial firms in different reporting countries.

²³ See Table 2.2 in Chapter 2.

Interbank payable through and correspondent accounts

The legislation recognises that transactions involving offshore jurisdictions make it difficult for US authorities to follow the money earned by organised crime groups and global terrorist organisations. One way in which money is laundered is through correspondent banking and payment facilities, which are often manipulated by foreign banks to permit the laundering of funds by hiding the true identities of the parties involved in the transactions. To this end, section 312 creates special disclosure requirements for foreign banks that maintain correspondent accounts²⁴ and other private banking accounts at US financial institutions²⁵ which requires US financial institutions to establish 'appropriate', and, if necessary, enhanced due diligence procedures to detect and report instances of money-laundering.

Section 311(e) defines a 'payable-through account' as 'an account, including a transaction account ... opened at a depository institution by a foreign financial institution by means of which the foreign financial institution permits its customers to engage, either directly or through a sub-account, in banking activities usual in connection with the business of banking in the United States'. New and enhanced due diligence standards are required for US financial institutions that enter into correspondent banking relationships with foreign banks that operate under *either* an offshore banking licence,²⁶ or a banking licence issued by states that have been (1) designated as NCCTs by FATF with the concurrence of the US representative to that body, or (2) subject to special measures set forth under section 311 (see above). Moreover, section 312 creates new minimum due diligence standards for maintenance of private banking accounts by US financial institutions.

Section 313(a) prohibits certain covered financial institutions²⁷ from establishing, maintaining, administering or managing correspondent accounts with 'shell banks', which are defined as a foreign bank that has no

²⁴ Section 311 defines 'correspondent account' with respect to banking institutions as an account 'established to receive deposits from, make payments on behalf of a foreign financial institution, or handle other financial transactions related to such institution.' This amends 31 U.S.C. §5318A (e)(1)(B).

²⁵ See 31 U.S.C. §5318 (i)(amending the Bank Secrecy Act).

²⁶ An offshore banking licence is defined as a licence to conduct banking business, where a condition of the licence is that the bank may not offer banking services to citizens of, or in the local currency of, the jurisdiction issuing the licence. See Supervisory Letter SR 01–29, Board of Governors of the Federal Reserve System. (26 Nov. 2001).

²⁷ 31 U.S.C. §5318(j) defines 'covered financial institution' as (1) any insured bank (as defined in s. 3(h) of the Federal Deposit Insurance Act (12 U.S.C. §1813(h)); (2) a commercial bank or trust company; (3) private banker; (4) an agency or branch of a foreign bank; (5) a credit union; (6) a broker or dealer registered with the Securities and Exchange Commission under the Securities and Exchange Act of 1934 (15 U.S.C. §78a *et seq.*

physical presence in any jurisdiction.²⁸ This provision also requires covered financial institutions to take 'reasonable steps' to ensure that correspondent accounts provided to foreign banks are not being used indirectly to provide financial services to foreign shell banks. In addition, section 319 (b) requires covered financial institutions which provide correspondent accounts to a foreign bank to maintain records of the owners of the foreign bank and the designated agent in the United States to accept service of legal process.

An exception exists, however, to permit a covered financial institution to maintain correspondent accounts with foreign shell banks that are affiliated with a depository institution, credit union, or foreign bank that maintains a physical presence in the US or in another jurisdiction, and the shell bank must be subject to supervision by the banking authority that regulates the affiliated entity.²⁹ The broad definition of 'covered financial institution' means that non-bank institutions, such as brokers and dealers in securities that operate in the United States, will be prohibited from establishing, maintaining, administering or managing an account for a foreign shell bank that is not a regulated affiliate.³⁰ To qualify as a regulated affiliate, the affiliated depository institution must demonstrate that it is regulated by a regulatory authority whose standards comply with generally accepted international norms as set forth by international bodies (i.e. FATF).

During the congressional debate surrounding enactment of the Patriot Act, securities and investment firms were recognised as the 'weak link' in efforts to combat financial crime and international terrorism. The US Congress's General Accounting Office (GAO) estimated that in the 1990s securities firms involved in broker/dealing operations and corporate finance have had in excess of \$100 billion laundered through their accounts. A major reason why securities firms have been vulnerable to laundering schemes is that they have not been subject to the same reporting and disclosure obligations as commercial banks. The GAO Report called securities and investment firms a 'money laundering loophole' and a 'weak link' allowing money launderers to invest with minimal scrutiny. Some of the largest securities firms (those with assets in excess of \$10 billion) and mutual funds have responded by voluntarily adopting procedures to attack money-laundering, but there has been no way for regulators to assess the quality of these programmes. Moreover, this does not take account of the many smaller

²⁸ Sec. 313(a) *codified at* 31 U.S.C. §5318(j)(effective date 25 Dec. 2001). A physical presence is a place of business that is maintained by a foreign bank and is located at a fixed address, other than solely an electronic address, in a country in which the foreign bank is authorised to conduct banking activities. *Ibid.*

²⁹ The Act defines 'affiliate' as a foreign bank that is controlled by or under common control with another institution.

³⁰ Sec. 313(a) *codified and amended at* 31 U.S.C. §5318 (j).

financial firms – brokerage and investment trust companies – that do not have money-laundering programmes in place.

The Patriot Act seeks to address this by requiring any firm or company that is defined by the regulations as a ‘financial services firm’ to do the following: conduct more due diligence of account holders, with an emphasis on private banking clients; establish anti-money-laundering programmes and policies; report suspicious activities to the Treasury; terminate all financial transactions with unregulated ‘shell banks’; and obtain more information through due diligence from foreign banks operating in jurisdictions that do not comply with international standards set forth by international bodies, such as the Financial Action Task Force. These requirements also extend to commodity brokers.

Requiring the identification of the ‘foreign beneficial owners’ of accounts with US financial institutions may create a disclosure obligation for many companies and trusts who are organised in foreign jurisdictions that might conflict with secrecy requirements under local law. Moreover, some jurisdictions make it a criminal offence to disclose information that identifies beneficial owners of shares in certain companies or the beneficiaries under certain trust arrangements. Such obligations imposed under foreign law could create a direct conflict with US disclosure requirements. To avoid the potential liability arising from foreign sovereign compulsion, section 319 takes account of this by vesting authority in the Attorney General to suspend or terminate a forfeiture under this section if the Attorney General determines that a direct conflict of laws exists between the laws of the jurisdiction in which the foreign bank is located and the laws of the United States with respect to liabilities arising from the restraint, seizure, or arrest of such funds, and that such suspension or termination ‘would be in the interest of justice and would not harm the national interests of the United States.’³¹

Efforts at cooperation and coordination with foreign regulators

The Act requires the Treasury Secretary, the Secretary of State, and the Attorney General to undertake ‘reasonable steps’ to encourage foreign governments to require the disclosure to US authorities of the names of a party who is the originator of wire transfer instructions sent to the United States, and to report annually to the relevant US congressional committees regarding any progress made with foreign regulators to accomplish this objective.³² Moreover, Title III requires the President to direct these executive officials to co-ordinate their efforts with the Federal Reserve Board in negotiating with

³¹ Sec. 319 (a)(1)(B).

³² Sec. 328.

foreign supervisory authorities or foreign officials to ensure that non-US financial institutions maintain adequate records that relate to the accounts or transactions involving alleged terrorist organisations, or any person engaged in money-laundering or other financial crimes.³³ US authorities should seek to obtain such records from foreign financial supervisors, and to make the records available to US law enforcement authorities and financial regulators where appropriate.³⁴ Congress has also stated an overall policy objective of encouraging US banking and securities regulators to institute negotiations with foreign supervisory authorities for the purpose of developing international norms and rules that would require national authorities to enhance regulatory disclosure standards and to coordinate with foreign authorities in the investigation of terrorist financing and money-laundering.³⁵ The regulations that implement these statutory provisions are likely to grant authority to US financial regulators to negotiate bilateral agreements and other understandings with foreign regulators in order to facilitate the enforcement of financial sanctions on a transnational basis.

The mandatory language of the USA Patriot Act indicates that US regulators will take a more assertive negotiating posture with other members of international bodies in order to achieve more precise and effective international standards and rules for the supervision and regulation of financial institutions with respect to financial crime and terrorist financing. Since the attacks of 11th September, the US Congress and the relevant US financial regulators have expanded the extra-territorial scope of US economic sanctions and have engaged foreign regulators to adopt more effective measures to identify the sources of suspicious financial transactions and to interdict terrorist financing.

UK financial sanctions against terrorism

Similarly, the UK government adopted expansive principles of criminal liability in the Anti-Crime, Security and Terrorism Act 2001, which amended the Terrorism Act 2000. Section 15 creates an offence for a person to solicit, or to receive, money or property on behalf of terrorists if the person knows or has reasonable cause to suspect that such money may be used for the purpose of terrorism. Similarly, a person is prohibited from providing money or other property if he knows, or has reasonable cause to suspect, that it will be used for the purpose of terrorism. Section 17 adopts the concept of the knowingly concerned person in creating an offence for a person who enters into, or becomes concerned in, an arrangement in which money or property is made available to another, and the person knows or has cause to

³³ Sec. 330.

³⁴ *Ibid.*

³⁵ *Ibid.*

suspect that it may be used for terrorism. Section 19 requires a person who becomes aware in the course of his employment or business of another person who has committed the offence of financing terrorism to disclose such information to a constable or a designated company officer. Section 21 covers all firms in the regulated sector by creating an offence for a person who fails to disclose knowledge or suspicions of another person (i.e. a client) who may be involved in the financing of terrorism. As in section 19, the disclosure must be made to a constable or designated firm officer. These provisions appear to adopt a knowledge standard for third party liability that can be satisfied by *either* a subjective knowledge test or an objective reasonable person test.

In addition, the UK has adopted secondary legislation (SI No, 3365) to implement the UN Convention for the Suppression of the Financing of Terrorism (1999) that prohibits any person from making 'any funds or financial (or related) services available directly or indirectly to or for the benefit of' a terrorist or organisation or company owned or controlled by a terrorist.

Moreover, regarding the issue of extra-territorial jurisdiction, the Terrorism Act 2000 creates new offences of international terrorism that allow UK courts to deal with terrorist acts and their planning, wherever in the world those acts are carried out. However, regarding third party financing of such acts, the Anti-Crime, Security and Terrorism Act 2001 expressly states that freeze orders will not have extra-territorial effect on the foreign branches of UK-based companies or financial institutions. This would also seem to suggest that other third parties acting outside UK territory, either directly or indirectly in support of terrorism, will not be covered by the Act.

Despite some limitations in jurisdictional reach, the UK legislation is an important step in addressing the problem of third party financing and support of terrorist activity, but it does raise a number of questions that have not been clarified in secondary legislation. For example, if aiding a terrorist is now a crime, it presupposes a criminal intention. Will every employee of firms in the regulated sector be informed or updated and kept abreast of persons on the terrorist list and the type of commercial activities and enterprises in which they are involved? An obvious defence might be that the person accused of aiding a terrorist had no reasonable grounds to suspect that he was dealing with a terrorist because of a change in identity or a switch in commercial activities. Other issues that may arise concern the burden of proof, and on whom will it fall. Does it fall on the prosecution or does it fall on the accused to prove that he did not know that the person named was a terrorist? US financial sanctions regulations have adopted a civil enforcement regime that shifts the burden of proof to the accused to demonstrate, on the balance of the probabilities, that its commercial activities or property was not involved with terrorist groups. Devising an effective enforcement regime will be one of the many challenges facing countries that create third party liability for financing and supporting terrorists.

Also, the issue of US extra-territoriality has re-emerged in the financial war on terror to cause strains between the US and other countries seeking to combat international terrorism. Supporters of US extra-territorial sanctions argue that they are a necessary tool of foreign policy to prompt foreign governments to take action against perceived international threats. However, the use of targeted financial sanctions has been criticized on a number of grounds. Most of the thousands of alleged terrorists and their supporters who have been designated by the US are not US citizens and live abroad. Because these designations are only subject to a very narrow scope of judicial review under US law, there is a real concern that many innocent people and business entities in Europe are being targeted without adequate procedural safeguards (except for assurances provided by US intelligence officials). In Europe, there are protections against arbitrary government action under the European Convention of Human Rights and the UK Human Rights Act 1998. However, the potential exists that because of the UK's close intelligence relationship with the US, UK authorities could be recognising US designations without proper procedural safeguards. This is an area where UK policymakers and regulators should remain vigilant. Although Title III of the Patriot Act has extra-territorial provisions with broad reach, the US has applied these controls rather sensitively in recent years, but if they were to embark on more aggressive enforcement then it may prompt EU countries to resort to EU blocking legislation.

Patriot Act financial sanctions against Banco Delta Asia

The recent case of the United States imposing financial sanctions against the Macao bank *Banco Delta Asia* in order to block North Korea's access to US dollars raises a number of important legal and regulatory issues for regulators and demonstrates the growing importance of US financial sanctions as an instrument of foreign policy against rogue states and money launderers. The case also raises concerns regarding the actual effectiveness of US financial sanctions and whether the sanctions achieved its objective of forcing North Korea to cease its nuclear weapons programme, or was it a combination of US sanctions, Chinese and other countries' sanctions that brought about the desired result? Moreover, the *Banco Delta* case raises issues regarding how host jurisdiction regulators should react to a declaration of US unilateral sanctions and what measures should be taken to protect the stability of the host jurisdiction's banking system when a bank based in the jurisdiction is targeted by US sanctions. The actions of the host monetary authority will have important legal and regulatory implications for determining the validity and effectiveness of multilateral and US sanctions and how they should be implemented in domestic financial systems.

The Macau Monetary authority's blocking orders against Banco Delta Asia

Banco Delta Asia is a small bank based in Macau, the Portuguese protectorate and offshore financial haven, with eight branches in Macau and a subsidiary in Hong Kong where it has two branch offices. On 15 September 2005, the US Treasury Department publicly accused Banco Delta Asia of being 'a willing pawn for the North Korean government,' and alleged that the bank had helped the North Korean government to conduct 'surreptitious, multi-million dollar cash deposits and withdrawals' for front companies involved in counterfeit currency, cigarette smuggling, and drug trafficking. At the time, the US authorities stated that they were considering whether to impose blocking orders against Banco Delta Asia (BDA) and prohibit all US financial institutions from doing any business with the Macanese bank. Although BDA officials disputed the US allegations, the following day BDA depositors suddenly withdrew the equivalent of \$40 million in US dollars from the Macanese branches. This led the Macau Monetary Authority to conduct an investigation of BDA and to appoint in September 2005 a committee of three directors to manage the bank's business. Moreover, Macanese authorities froze over fifty North Korean accounts at the bank with more than twenty five million US dollars.

Some of the frozen accounts included twenty held by state-owned North Korean banks, eleven by private trading companies and nine by individuals. US authorities had accused many of these account holders over the years of engaging in counterfeiting US currency and of financing the development of weapons of mass destruction. This action caused foreign regulators in other jurisdictions to fear that banks in their jurisdictions might become the target of US sanctions as well if they were associated as doing business with BDA and its North Korean accountholders. As a result, Chinese regulators at the People's Bank of China Bank froze North Korean accounts at the Bank of China's Macau's branch in October 2005. This was followed by similar blocking actions in December 2005 by Vietnamese and Mongolian regulators against banks in their own jurisdictions that had held US dollar accounts for the North Korean government and its businesses. These regulatory restrictions had a tremendous impact on the North Korean economy: the won dropped sharply on the black market, and UN foreign aid providers found it difficult to transfer money into North Korea. Moreover, many North Korean businesses were also caught by the Macau blocking orders. The Daedong Credit Bank, a joint venture between the state-owned North Korean Daesong Bank and a Hong Kong-based investment company controlled by a British fund manager, had seven million of its funds in BDA frozen by the Macau Monetary Authority.

These North Korean businesses threatened legal action against the Macau Monetary Authority on the grounds that their bank accounts at BDA were

subject to Macanese law which required that the depositors have access to their funds according to the terms of their banking contracts. Macau's Monetary Authority, however, had intervened to block the accounts as part of a supervisory action to stabilise the BDA bank and to prevent it from collapse as a result of the bank-run panic that had resulted from the US declaration that BDA was acting as a pawn of the North Korean government in facilitating economic crime activity. The Macau Monetary Authority's appointment of a three-man board of directors to manage the affairs of BDA and to ensure that it was not facilitating transactions for the North Korean government with US dollar assets was upheld by the Macau government and its legal advisers as a lawful exercise of its supervisory powers.

The Macau Monetary Authority's action in imposing a blocking order against the US dollar accounts of North Korean account holders set off a chain reaction in global financial markets leading many other regulators to block North Korean dollar accounts as well. It was remarkable how the blocking orders by the Macau Monetary Authority against BDA had resulted in other regulators imposing blocking orders on bank accounts in US dollars in their jurisdictions held on behalf of North Korean account holders. As US authorities observed in March 2006, the reaction of other regulators in imposing freeze orders against BDA US dollar accounts was 'merely market forces doing their job'.³⁶ These actions were taken without US authorities having yet imposed their own unilateral blocking orders against BDA dollar accounts which occurred later in March 2007. The effectiveness of these US sanctions was not that they targeted North Korea, but that they had targeted one of the banks (albeit a small one) that was facilitating dollar payments on behalf of the North Korean government, businesses and individuals.

Without access to the US dollar accounts, the North Koreans found it difficult to conduct cross-border trade finance and to clear US dollar deposits from various North Korean businesses – both legitimate and illegitimate. Combined with existing US economic sanctions, the US declaration and subsequent political pressure on other Asian countries to terminate dealings with BDA had increased substantially the economic pressure on North Korea to submit its nuclear facilities to international inspection and to cease using US currency to finance criminal activity. Initially, the US actions, however, did not seem to produce the desired result when in July 2006 North Korea test-fired eight missiles and on 9th October 2006 it detonated an underground nuclear device. The UN Security Council responded by passing a sanctions resolution on 14th October that barred North Korea from importing military equipment and materials that could be used in its nuclear programmes and prohibited exports to North Korea of certain luxury goods.

³⁶ 'How U.S. wielded financial tools to put pressure on North Korea' in *Wall Street Journal*, (12 April 2007) Jay Solomon and Neil King pp. 1415 (citing statement of US Assistant Secretary of the Treasury Daniel Glaser).

Moreover, China began to increase its own unilateral pressure on North Korea by increasing border inspections on trucks bound for North Korea. The Chinese campaign was rumoured to be part of a broader strategy to prevent North Korea from going forth with a second nuclear test, or possibly to use China's economic leverage to force Kim Yong-Il to give up his nuclear programme.³⁷

Moreover, in late October 2006, Chinese banks announced that they were halting transactions with North Korea to pressure North Korea to return to multilateral disarmament talks which had broken down in 2004.³⁸ The Chinese financial system has long served as a major conduit for North Korea to exchange money with the outside world. China also is a major supplier of food and oil for North Korea. How strictly China enforced the UN sanctions and its additional unilateral measures were important factors in determining the amount of pressure brought to bear on Pyongyang and the extent of any concessions which they were about to make.

Over the next few months, the so-called six-party negotiations involving the US, North Korea, South Korea, China, Japan and Russia resumed.³⁹ In the negotiations, the US began to use the possibility of unblocking the US dollar accounts at Banco Delta Asia as a 'carrot' to induce the North Koreans to make concessions on their nuclear weapons development and weapons inspections. The Chinese sanctions, however, had begun to take their toll as well with Chinese businesses and financial firms gradually slowing their economic activity with North Korea. It all culminated on 13th February 2007 when North Korea signed an agreement with the other five parties to the talks in which it promised to end its nuclear weapons development programmes and to shutdown the Yongbyon nuclear facility and to allow the return of international inspectors to the facility to verify this within 60 days of the 13th February agreement. This agreement was an example of how both positive and negative economic sanctions can achieve their objectives. North Korea agreed to discontinue its plutonium development programme at Yongbyon in return for US aid and support in the development of a peaceful civilian nuclear programme. The agreement also called for the phasing out of US financial sanctions and UN sanctions against North Korea and for the US and other countries to provide humanitarian support and heavy water and petroleum for North Korea's civilian nuclear fuel programmes in return for North Korea renouncing nuclear weapons.

³⁷ China was also trying to balance its approach between punishing North Korea for its weapons testing, but not imposing too severe of sanctions because it might have resulted in an economic and/or refugee crisis.

³⁸ The major Chinese banks that announced ending their financial dealings with North Korea were: Shanghai Pudong Development Bank, China Construction Bank Corp., and China Citic Bank.

³⁹ The six countries involved in the negotiations are: South Korea, North Korea, China (PRC), Japan, Russia, and the United States.

Initially, the February 13th agreement faced implementation difficulties. After the US State Department reached the February agreement with the North Koreans, the US Treasury bizarrely announced on 14 March 2007 that it was imposing special measures to block all correspondent and inter-bank payable through accounts and banking transactions with Banco Delta Asia. Utilising section 311 of the Patriot Act, the Treasury ordered all US financial institutions and their foreign correspondent banks to block all US dollar accounts with BDA. This had the effect of ordering all banks in the world to block any US dollar accounts they held with BDA. The US order was based on US intelligence findings that were the basis of the September 2005 US declaration that the North Korean government and various business entities were using BDA accounts to make payments for smuggled cigarettes, to deposit counterfeit US currency, and to purchase materials to support North Korea's nuclear weapons programmes. The US order created a furore and threatened to derail the February agreement. The US finally agreed that it would exempt the twenty five million in North Korean dollar accounts held at BDA from the order.

More difficulties arose, however, as US authorities proposed to Macau authorities that the twenty five millions in blocked US dollar accounts be transferred to the Bank of China in Beijing. The Chinese balked at this because of the potential that they might be subject to US Patriot Act sanctions for holding tainted money on behalf of the target of US sanctions. Several other banks in other jurisdictions, including Hong Kong and the US, were considered as potential recipients of the tainted funds. The potential for reputation risk, however, made it difficult to find a willing bank to receive the North Korean funds. Finally, on 17 June 2007, US officials reached agreement with Russia's President Putin and the Russian Central Bank that the funds could be deposited with a private Russian bank and held until all undertakings had been fulfilled by the US and North Korean parties before being sent on to the North Korean accountholders.

The agreement has taken effect with only some uncertainty regarding North Korea's ongoing compliance with its obligation to cease development of plutonium and uranium enrichment at its nuclear facilities. The case of Banco Delta Asia and its dollar accounts held for its North Korean accountholders highlights some of the difficult legal and regulatory issues that confront regulators and bankers because of the application of US financial sanctions. US policymakers expected North Korean reliance on US dollar accounts to be the weak point they needed to put the most pressure on North Korea to change its course of conduct. The September 2005 declaration by the US put pressure on the Macau Monetary Authority which led them to block the North Korean accounts at BDA. However, this turned out not to be enough to bring the North Koreans to the bargaining table and therefore the US was forced to seek the support of other countries to put economic pressure on North Korea by imposing financial sanctions. In this case, once China and

other Asian countries began restricting their dollar transactions with North Korea, North Korean authorities agreed to make concessions by opening up their nuclear plants for inspections on the condition that they receive aid and that the financial sanctions were lifted.

The Banco Delta Asia case reinforces the need for more coordination and cooperation between US regulators and their counterparts in other countries to ensure more effective implementation and monitoring of financial sanctions. US sanctions would not have achieved their objectives if they had not been coordinated and combined with the sanctions policies of other important countries (in this case China and the Macau Monetary Authority). Future applications of the Patriot Act to foreign bank accounts will achieve their objectives only if US authorities coordinate with foreign regulators and central bankers to ensure that all regulatory and legal issues of the implicated jurisdictions are addressed adequately.

In addition to the legal tools which the US government can apply under the Patriot Act and other economic sanctions laws, it has also engaged in direct political pressure on European and Asian governments and foreign banks and large companies not to do business with another US-designated state sponsor of terrorism – Iran. US officials have called this type of indirect economic pressure *de facto* financial sanctions and are using them against many developed country governments and their banks and companies in order to isolate Iran in the international financial system. The risk of such reputational damage has caused many European banks to announce the cessation of financial dealings with Iran, even though they are under no legal obligation to do so. For instance, in January 2006, two of the world's largest non-US banks, UBS and Credit Suisse, announced that they would cease all business and financial dealings with the Iranian government and Iranian controlled entities because of reputation risk and pressure by the US Treasury.

The effectiveness of these *de facto* economic sanctions, however, has not been determined and it would be speculative at best to say that these sanctions combined with the Patriot Act's section 311 measures will persuade Iran to cease its uranium enrichment and plutonium development programmes in the same way that North Korea did when they suffered section 311 sanctions. Indeed, Iran poses a far greater challenge than North Korea because its economy is far more integrated into the international financial system and it is uncertain what type of support, if any, can be obtained from Iran's neighbouring countries to support any multilateral or US sanctions.⁴⁰

⁴⁰ An IMF study reports that Iran had \$51 billion of exports and \$48 billion of imports in 2005.

Conclusion

International terrorism and terrorist financing are the primary targets of international and national sanctions policymakers. The emergence of an international regime of anti-terrorists financing measures has dramatically changed the nature and scope of economic sanctions. Financial sanctions are now being targeted in more limited and precise manner against terrorists and those who support them. The US Patriot Act is an important example of a comprehensive statutory framework that attempts to target the foreign sources of financial crime. It builds on existing US economic sanctions programmes to target international terrorists and their financiers and supporters by using extra-territorial regulation of third country financial institutions and firms to promote US anti-terrorism and financial crime policy. Title III contains the key provisions that apply to US and foreign banks and financial institutions. Generally its provisions provide authority for the Treasury Secretary to take targeted action against countries, institutions, transactions, or types of accounts that the Secretary finds to be of prime money-laundering concern. It also requires high standards of due diligence for correspondent accounts and inter-bank payable through accounts opened at US financial institutions by foreign offshore banks and banks in jurisdictions that are targeted by US officials as being of special concern for financial crime.

The enforcement of the Patriot Act has created problems for foreign jurisdictions and their financiers who manage US dollar assets in overseas banks. The North Korean/Banco Delta case provide an interesting case study for how extra-territorial financial sanctions can appear to achieve their objectives by causing a change in behaviour of targeted states. The Patriot Act sanctions, however, only achieved their objective in this case because the Chinese were exerting economic pressure on North Korea by restricting banking and trade and cross-border movement of people between the two countries. This was probably the determinative factor in obtaining the desired concessions from the North Koreans. The case demonstrates that the absence of effective multilateral coordination mechanisms for dealing with the implementation of financial sanctions across national jurisdictions suggests that there is a role for international regulation to play in this area. Efforts at mutual assistance and at building effective multilateral institutions therefore are necessary for developing a more legitimate international regulatory system to oversee economic sanctions policy. The following chapter will address how some international and regional institutions have addressed the coordination problem for national sanctions practice and what role, if any, multilateral institutions can play in promoting more effective and legitimate economic sanctions policies.

11

Economic Sanctions Reform and International Institutions

It is very interesting to me to observe how from every quarter, from every sort of mind, from every concert of counsel, there comes the suggestion that there must now be, not a balance of power, not one powerful group of nations set off against another but a single overwhelming, powerful group of nations who shall be the trustee of the peace of the world.¹

Woodrow Wilson
28 December 1918
Address at the Guildhall, London

Introduction

As discussed in chapter 1, Woodrow Wilson's vision for collective security in the League of Nations involved economic sanctions playing an important role in deterring nation states from using armed aggression to settle their disputes. Although Wilson's League foundered on the rocks of militarism and great power rivalries, it provided the basis for the creation of the United Nations and for the institutional authority of the General Assembly and Security Council to adopt international economic sanctions. Indeed, the UN Security Council may adopt resolutions pursuant to chapter VII of the UN Charter which authorise it to take whatever measures necessary, short of the use of force in response to a breach of peace and security or a threat to peace and security. These measures may include economic sanctions against targeted states or non-state actors. In the 1990s, the Security Council began using economic sanctions more often against states and non-state actors. The most prominent episode of UN economic sanctions during this period was against Iraq, which occurred between 1991 and 2003, and they were the most comprehensive imposed against any country in modern times. This

¹ *The Papers of Woodrow Wilson*, vol. 53, 9 November 1918–11 January 1918, A. Link (ed.) (Princeton: Princeton University Press).

chapter suggests that their success in disarming and incapacitating Saddam Hussein's weapons development programme can be a model for devising future sanctions regimes against recalcitrant states.

The chapter will also examine the role of international institutions in developing sanctions to combat international terrorism with particular focus on the UN institutions – the General Assembly and the Security Council – which have established an extensive international sanctions regime that targets the financing of terrorism. The chapter will analyse the institutional structure of the Security Council's sanctions committees and the particular challenges they face in adopting financial sanctions against terrorists and their supporters. Of particular importance will be the legal and regulatory issues that confront national authorities in implementing the terrorism committees' financial sanctions requirements. The efforts of other international financial bodies will be discussed as they relate to the targeting of terrorist finance. Also discussed will be the approach of the European Community in implementing the UN sanctions regime that targets terrorist finance.

I The Security Council and the case of Iraq

Following the US-led invasion of Iraq, it became evident that Saddam Hussein's government possessed no weapons of mass destruction (WMD). Iraq's military capacity and supposed WMD programme had been eviscerated by the combined results of the first Gulf war, twelve years of comprehensive UN sanctions, and the dismantlement and extensive monitoring of its weapons programmes by the United Nations Special Commission (UNSCOM). It is difficult to exaggerate the important role that UN sanctions played in limiting the Iraqi regime's ability to rebuild its weapons capacity. Although UN sanctions did not succeed in persuading Saddam Hussein to comply with all the conditions of the Security Council's mandate that ended the first Gulf war, they were certainly successful in preventing Iraq from developing any meaningful weapons capacity that could serve as a threat to its neighbouring countries.

The UN sanctions regime was successful in part because it prevented the Iraqi government from having direct access to its vast oil and gas reserves. During the twelve years that the sanctions regime was in place, the UN denied the Iraqi government most of the income from Iraqi oil sales. This was estimated to be over \$175 billion in oil export revenues between 1991 and 2003. Although Iraq gained significant oil revenues through bribes and smuggling that were estimated at between \$2 and \$4 billion annually, these revenues were insufficient to develop a substantial weapons programme that could pose a meaningful threat.

To alleviate the collateral damage that UN sanctions were imposing on the Iraqi civilian population, the Security Council adopted in 1995 Resolution 986 that authorised the oil-for-food programme. The programme was

designed to allow certain imports covering oil production and transportation so that Iraq could rebuild its oil industry and use some of its oil export revenues to purchase food and medicine for Iraqi civilians, while denying the Iraqi regime direct use of the revenues for its military and security apparatus. The oil-for-food programme, however, was poorly administered by the UN and was plagued with graft involving UN officials, contractors and the Iraqi government. Although the programme failed to prevent the Iraqi regime from diverting revenues away from humanitarian concerns to Iraqi government operations, it represented an important first step in designing a more targeted and focused international sanctions regime that sought to achieve security objectives while not imposing disproportionate social costs.

In response to the need for more targeted sanctions, the Security Council adopted Resolution 1409 in May 2002 which fundamentally restructured the Iraqi sanctions regime. The resolution lifted the controls that had been imposed on the shipping of goods to Iraq, while maintaining the arms embargo and creating new controls on the transfer of technology. The resolution enhanced the Goods Review List (GRL) that had been created under resolution 1382 in 2001 to include specific dual-use items that were subject to approval according to procedures set forth in the resolution's annex. Under this system, civilian goods and services would be allowed free access to Iraqi trade, while designated dual-use goods, services and technologies would be subject to monitoring and approval.

The resolution shifted the focus of UN sanctions away from a comprehensive prohibition on civilian trade with limited exceptions to more targeted and specific controls on the import of arms and military-related goods and technologies. These targeted sanctions were intended to provide more humanitarian relief for Iraqi civilians than what had become available under the oil-for-food programme, while maintaining an effective prohibition on the arms trade and precisely applied curbs on the flow of dual-use goods and technologies. As Cortright and Lopez (2002, 4) observed, Resolution 1409 created 'a more sustainable UN policy of sanctioning weapons and military-related technology'.

The precise design and calibration of an effective international sanctions regime, however, should not overlook the importance of gaining adequate political support from the relevant states needed to implement a sanctions policy. Many of the problems concerning domestic implementation of the Iraq sanctions regime and cross-border co-operation for enforcement were undermined by political differences regarding the scope and intensity of the sanctions and what conditions should be required to have them lifted. For instance, France and Russia were of the view that 'a carrot and stick' approach should be used in which a timescale for lifting the sanctions would be given to Iraq in return for it demonstrating that it had complied with specific conditions of the UN mandate. By contrast, the US was determined not to

allow an easing of sanctions until fundamental regime change had occurred in Iraq. Moreover, these differences were exacerbated in the last years of the sanctions regime by deep disagreements between the permanent five over a formula for resuming weapons inspections.

The lesson of the UN sanctions programme against Iraq is that multilateral sanctions can achieve certain strategic objectives of an economic nature, such as limiting the target state's ability to acquire technology and resources to develop weapons programmes, and to keep the regime politically isolated in the international community. Nevertheless, even though sanctions may achieve their economic and strategic objectives, they may fail completely in persuading the target to adhere to international norms or conditions imposed by the sanctioning states.

The case of Iraq has important implications for how the Security Council should deal with Iran. It is generally accepted that Iran is developing a uranium enrichment programme in a manner which could allow it to develop nuclear weapons in violation of non-proliferation treaties. The Iranian leadership, however, argues that the sole purpose of its uranium enrichment programme is to provide for civilian energy needs. Nevertheless, the International Atomic Energy Agency (IAEA) has expressed a great deal of concern over the Iranian programme and the willingness of Iran to allow IAEA inspectors meaningful access to Iranian installations. The UN sanctions regime, embodied principally in resolutions 1737, 1747 and 1803, is one that is focused on restricting Iran's access to financial resources and the technologies and equipment that would allow it to enrich uranium and potentially develop weapons of mass destruction.

The available evidence suggests that Iran may be a decade away from developing a nuclear weapons threat and ballistic missile capabilities. There is plenty of time therefore to apply an effective targeted UN sanctions programme that prevents Iran from acquiring weapons material and dual-use technologies and equipment. Moreover, targeted financial sanctions can be applied against its banking sector to constrain Iran's ability to finance the purchase of material and technologies that could develop its nuclear weapons industry. As with Iraq, a combination of targeted sanctions, diplomatic pressure, and military containment could prevent Iran from acquiring a WMD capacity.

II United Nations General Assembly measures against terrorism

The General Assembly has led international efforts to combat terrorism by adopting a number of resolutions and conventions. The General Assembly's efforts, however, have been limited by a lack of an international consensus concerning the definition of terrorism. This has hindered international

organisations and multilateral bodies from developing a consensus on what terrorism is, as opposed to criminalising the acts that often constitute terrorism. The United Nations General Assembly has adopted several important resolutions and conventions that address some of the more specific manifestations of international terrorism, such as airline hijackings, airport violence, piracy and hostage taking.² These international instruments require all UN member states to criminalise certain specified terrorist acts under their domestic laws. It was not until the 1990s, however, that the General Assembly began to address the ancillary activities that support international terrorism. In 1994, the General Assembly adopted Resolution 49/60, which reaffirmed existing UN 'condemnation of all acts, methods, practices of terrorism as criminal and unjustifiable'.³ The resolution also encourages states to undertake urgent review of the scope of existing international legal provisions on the prevention and repression of terrorism in all its forms to ensure that all aspects of terrorism are prohibited. To this end, General Assembly Resolution 51/210 recognised the threat posed by so-called charitable and cultural organisations serving as fronts for terrorist fundraising and training, and called upon all states to take domestic measures to prevent and counteract the use of non-profit and business

² Since 1963, the international community has adopted 13 international legal instruments to prevent terrorist acts. GA Res. 49/60 (9 Dec. 1994) (including 'Annex on the Declaration of Measures to Eliminate Terrorism'). 1963 Convention on Offences and Certain Other Acts Committed On Board Aircraft (*Aircraft Convention*). 1970 Convention for the Suppression of Unlawful Seizure of Aircraft (*Unlawful Seizure Convention*). 1971 Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (*Civil Aviation Convention*). 1973 Convention on the Prevention and Punishment of Crimes Against Internationally Protected Persons (*Diplomatic Agents Convention*). 1979 International Convention against the Taking of Hostages (*Hostages Convention*). 1980 Convention on the Physical Protection of Nuclear Material (*Nuclear Materials Convention*). 1988 Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (Extends and supplements the Montreal Convention on Air Safety) (*Airport Protocol*). 1988 Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation (*Maritime Convention*). 2005 Protocol to the Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation. 1988 Protocol for the Suppression of Unlawful Acts Against the Safety of Fixed Platforms Located on the Continental Shelf. 2005 Protocol to the Protocol for the Suppression of Unlawful Acts against the Safety of Fixed Platforms Located on the Continental Shelf. 1991 Convention on the Marking of Plastic Explosives for the Purpose of Detection (*Plastic Explosives Convention*). 1997 International Convention for the Suppression of Terrorist Bombings (*Terrorist Bombing Convention*). 2005 International Convention for the Suppression of Acts of Nuclear Terrorism (*Nuclear Terrorism Convention*).

³ GA Res. 49/60 (1).

organisations to support terrorists and facilitate terrorist activity.⁴ Although these General Assembly resolutions are not legally binding on UN member states, they strongly encourage states to devise legal and regulatory measures that monitor the global dimension of terrorist networks and interdict their cross-border activities.

The Convention for the Suppression of the Financing of Terrorism

The first major multi-national convention adopted with the express objective of requiring states to suppress the financing of terrorism was the International Convention for the Suppression of the Financing of Terrorism on 9 December 1999.⁵ The Convention, opened for signature on 9 September 1999, covers the offence of direct involvement or complicity in the financing or collection of funds for terrorist activity. The Convention recognises that the financing of terrorism is a matter of grave concern to the international community and requires states to adopt regulatory measures to prevent the flow of funds intended for terrorist purposes. Specifically, Article 2 (1) requires states to create an offence when a 'person by any means, directly or indirectly, unlawfully and wilfully, provides or collects funds with the intention that they should be used or in the knowledge that they should be used' to commit an act that constitutes a terrorist offence.⁶

Article 2 also defines an act as constituting a specific terrorist offence if it either (1) constitutes a specific offence within the scope of one of the nine UN Conventions listed in the Treaty Annex that address various types of terrorism, or (2) any other act intended to cause death or serious bodily injury to a civilian, or to any other person not actively taking part in hostilities involving armed conflict, when the purpose of such act was to intimidate a population, or to compel a government or international organisation to do or abstain from doing an act. It should be emphasised that the definition of a specific terrorist offence in Article 2 is narrower than the definition adopted

⁴ GA Res. 51/210 (17 Dec. 1996), paras. 3(a)-(f).

⁵ GA Res. 54/109, 4th Sess. (9 Dec. 1999).

⁶ Article 2 sets forth a definition of terrorist financing that provides in relevant part: '1. Any person commits an offence within the meaning of this Convention if that person by any means, directly or indirectly, unlawfully and willfully, provides or collects funds with the intention that they should be used or in the knowledge that they be used, in full or in part, in order to carry out: (a) An act which constitutes an offence within the scope of and defined in one of the treaties listed in the annex; or any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act.'

by the US government in Executive Order 13224, which defines a terrorist act as 'an activity that involves a violent act or an act dangerous to property or human life that appears intended to intimidate or coerce a civilian population or to influence the policy of a government by intimidation or coercion or to affect the conduct of a government by mass destruction, kidnapping or hostage taking.' This sweeping definition of the term terrorist offence adopted by the US government in the aftermath of the 11 September attacks has created conflicts with other countries regarding how to define terrorist acts for the purpose of imposing economic sanctions.

In addition, Article 8 requires each signatory state to take appropriate measures, according to local law, for the detection and freezing, seizure or forfeiture of any funds used or allocated for the purposes of the offences prescribed in section 2. Article 11 requires signatories to make offences prescribed in the Convention extraditable and to take jurisdiction over such offences by making them punishable with appropriate penalties. Under Article 18(1) national regulators of signatories are required to subject financial institutions and other professionals to 'know your customer' requirements that involve the identification and filing of suspicious transaction reports. Article 18(2) requires signatories to co-operate in preventing the financing of terrorism in the areas of licensing money servicing businesses, and measures to detect or monitor cross-border transactions. Article 18(3) requires signatories to co-operate through exchanging information with respect to terrorist financing.⁷ The Convention provides for those countries which have ratified it a legal basis to impose a broad and comprehensive economic sanctions regime against terrorist financing.

III United Nations Security Council Terrorism Committees

An important aspect of Security Council economic sanctions programmes has been the delegation of their administration and implementation to standing committees of government representatives and experts who issue reports and oversee implementation and compliance by UN member states with the requirements of Security Council sanctions measures.

The Al Qaida and Taleban Committee

Responding to terrorist attacks on the US embassies in Tanzania and Kenya in the late 1990s, the Security Council adopted several resolutions that

⁷ The Convention entered into force on 10 April 2002 after the required 21 states of the 129 signatories had deposited their instruments of ratification with the United Nations. The convention is now legally binding on all the countries that have ratified it. As of 2007, over one hundred countries have ratified the Convention (Cortright and Lopez, 2007).

addressed the problem of international terrorism and the role of states in supporting it. Specifically, Resolution 1214 of 8 December 1998 stated that the Security Council was deeply disturbed that Afghan territory was being used to shelter and train terrorists and to plan terrorist acts, and reiterated how important the suppression of international terrorism is for international peace and security. Resolution 1267 of 15 October 1999 stated that the failure of Taleban authorities to comply with Resolution 1214 was unacceptable and that the Security Council was authorised, under chapter VII of the UN Charter, to take all measures necessary to secure Taleban compliance with the resolution and to ensure that Osama bin Laden was handed over to any national authority which had indicted him (namely the US). Resolution 1269 of 19 October 1999 encouraged states to co-operate in identified ways to 'prevent and fight the threat to international peace and security as a result of terrorist activities'. Resolution 1333 authorised further economic sanctions against the Taleban and was the first Security Council resolution to require states to impose asset freezes without delay on the funds and assets of Bin Laden and his associates.

In targeting Al Qaida, bin Laden and the Taleban regime, Resolution 1267 established an international sanctions committee (the Al Qaida and Taleban committee) to oversee the designation or listing of terrorists associated with Al Qaeda and the Taleban.⁸ The resolution delegated authority to the committee to monitor these terrorists and to establish an international list of specific individuals and organisations allegedly associated with Al Qaida and the Taleban. The resolution required all UN member states to freeze the financial assets and block the availability of economic resources to the individuals and entities designated on this sanctions list. In addition, states were obliged to impose an arms embargo against the Taleban and Al Qaida and a travel ban against its officials and other designated individuals.

Resolution 1373 and the Counter-Terrorism Committee

The attacks on the United States of 11 September led the UN Security Council to take further steps against international terrorism by adopting two resolutions that require states to co-operate and participate in a global anti-terrorism regime by taking active measures to implement counter-terrorism and financial controls. The two resolutions are Resolutions 1368, adopted on 12 September 2001, and Resolution 1373, adopted on 28

⁸ Resolution 1333 instructs the Sanctions Committee to maintain an updated list, based on information provided by states and regional organisations, of the individuals and entities designated as associated with Bin Laden and the Taliban. para. 8. Significantly, paragraph 23 limited the obligation of states to impose freeze orders to 12 months, but the Security Council would have the authority to extend the obligation for continuous 12 month periods. In 2002, the Security Council adopted Resolution 1452 which provides a number of exceptions to the freeze orders which states may take based on humanitarian grounds. para. 1.

September 2001. Resolution 1368 condemned the attacks and called upon all states 'to work together urgently to bring justice to the perpetrators, organizers and sponsors of these terrorist attacks and stresses that those responsible for aiding, supporting, or harboring the perpetrators, organizers and sponsors of these acts will be held accountable'.⁹ The resolution calls on all states to increase their efforts 'to prevent and suppress terrorist acts' by increased co-operation and full implementation of the relevant international anti-terrorist conventions and Security Council resolutions, especially resolution 1269.¹⁰ The resolution also expresses the resolve of the international community to take 'all necessary steps to respond to the terrorist attacks of September 2001', and to combat all forms of terrorism, as provided under the UN Charter.

Resolution 1373 requires UN member states to prohibit all direct and indirect financing or support of all terrorists and terrorist organisations.¹¹ Resolution 1373 requires states to implement the UN Convention on the Prevention of Financing of Terrorism. To oversee implementation of the resolution's obligations, the Security Council formed a committee entitled the Counter-Terrorism Committee and delegated authority to it to monitor implementation of the resolution and to issue reports and assessments of state efforts in this area. Unlike the Al Qaida and Taleban committee, however, the committee does not target specified individuals or organisations. It is the responsibility of each member state to decide who is subject to targeted sanctions and to designate them domestically, and then to apply to the Counter-Terrorism Committee to have the domestic designations recognised and applied by other UN states.

The resolution requires states to prevent and suppress the financing of terrorist acts and to refrain from providing any type of support, active or passive, for terrorists and to deny safe haven to those who finance, plan or participate in terrorist acts.¹² The resolution emphasises the importance of freezing the assets of companies and entities owned or controlled by terrorist groups. Specifically, Article 1(b) requires states to create an offence for persons who wilfully provide or collect, by any means, directly or indirectly, funds with the knowledge that such funds would be used to carry out terrorist acts. Article 1(c) requires states to freeze without delay funds, financial assets, or other economic resources belonging to, or controlled by, persons who commit, or attempt to commit, terrorist acts. Article 1(d) addresses the issue of third party financing by requiring states to prohibit 'nationals or

⁹ Res. 1368.

¹⁰ Res. 1269 (19 Oct. 1999).

¹¹ The Committee is known as the United Nations Counter-Terrorism Committee. See 'Security Council Hears Report by Chair of UN Counter-Terrorism Committee', *U.N. Press Release* (18 Jan. 2002).

¹² Art. 2(c).

any persons and entities within their territories from making any funds, financial assets or economic resources or financial or other related services available, directly or indirectly, for the benefit of persons who commit or attempt to commit or facilitate or participate in the commission of terrorist acts'.

Another important provision in the resolution is Article 4, which requires that each state adopt such measures as may be necessary under its domestic law to establish the criminal offences set forth in Article 2, and 'to make those offences punishable by appropriate penalties which take into account the grave nature of the offences'. Under these provisions, the attempt to carry out the act of terrorism is not a prerequisite for committing the offence of financing terrorism. For the offence to be committed, all that is needed is the actual collection of funds, if it is undertaken with the intention to finance terrorist activities.

The implementation of this important provision may require many domestic legal systems to change the elements of certain criminal offences. For instance, the elements of existing aiding and abetting offences in many jurisdictions require an underlying criminal act or attempted criminal act for the aiding and abetting offence to be actionable. This would not be adequate for implementing the above treaty obligation to criminalise the financing of terrorism. It should be noted that criminalisation on the basis of *aiding and abetting* ordinarily depends on whether the main criminal act (i.e., a terrorist hijacking) has at least been attempted. It is exactly this precondition that is not required by the Terrorist Financing Convention.

As mentioned above, Resolution 1373 establishes an institutional mechanism to monitor implementation and requires UN member states to share information regarding activities and enforcement matters. The resolution expressly incorporates existing commitments made by UN members in previous international conventions, declarations and resolutions with respect to terrorism and makes them legally binding by invoking chapter VII of the UN Charter, which authorises the Security Council to take all necessary action, including imposing economic sanctions, to ensure that the objectives of the resolution are achieved. Resolution 1373's Counter Terrorism Committee consists of representatives of all the members of the Security Council whose responsibility is to monitor implementation of the resolution.

The Committee requires all UN members to report according to a timetable on the steps they have taken to implement the resolution. The Committee has the authority to set forth compliance procedures for states to adhere in ensuring that the resolution is implemented. The Resolution authorises the creation of a trust fund administered by the UN Secretariat and financed by member states to ensure that the Committee's monitoring function is effectively carried out. The Committee issues guidance to states on procedures for submitting compliance reports and also suggests areas where states could

improve their capacity in adopting legislative and executive measures to combat terrorism. Further, the Committee publishes a directory of contact points to promote global co-operation and has selected a group of independent experts to advise the Committee.¹³

States are required to submit reports regarding the legal, regulatory and enforcement measures they have taken to criminalise terrorist activity and to interdict terrorist financing. The experts who advise the committee assess individual country reports and set criteria for determining overall compliance with the requirements of Resolution 1373.¹⁴ Based on the information provided in the Reports, the Committee seeks to address three questions: (1) ascertain exactly what measures states have adopted thus far in criminalising terrorist financing as required by sub-paragraph 1(b) of the Resolution; (2) what measures states have taken to freeze funds, financial or other assets of persons or entities suspected of terrorist activities as distinct from freezing funds or financial assets of persons involved in money laundering; and (3) what preventive controls or surveillance procedures states are using to ensure that funds intended for the financing of terrorism are not transferred through charitable, religious or cultural organisations.

Some of the limitations of the Committee include that it will not intrude on the competence of other agencies in the UN system, and it will not seek to provide a legal definition of terrorism, although members will be encouraged to do so. Moreover, the Committee is not authorised to designate terrorists or terrorist organisations and has no competence to resolve disputes between states over the designation of terrorists. All such disputes are intended to be referred to the Security Council.

In the early years of the Committee's work, there was an expectation that its suggested standards and practices would emerge as 'minimum international standards for counter-terrorism law' (Zagaris, 2002, 39). The reality, however, has been quite different, as most states continue to follow disparate implementation practices while many states have not yet criminalised the knowing provision of financial support to terrorists, nor have they created civil liability standards for breach of sanctions laws. Most important, there is little interest on the part of most developing countries and many developed countries to incorporate the substantive requirements of the

¹³ The Committee emphasises transparency and has made its documents public via the Security Council website. See 'Note by the President of the Security Council', S/1996/54 (24 Jan. 1996).

¹⁴ The experts are expected to have expertise in the areas of finance, national legislation and law enforcement. The UN Secretariat will continue to identify experts for the Committee's ongoing work. See United Nations Press Conference, 'CTC 1373', (10 Jan. 2002) (copy on file with author).

resolution into domestic law or, if incorporated, to enforce these standards against designated terrorists and their supporters.

EU implementation of Security Council Terrorist Sanctions

The Council of Ministers of the European Communities decided as a general policy matter to implement the financial sanctions measures adopted by the Security Council terrorism committees. To that end, the Council of Ministers adopted a Common Position in 1999 to adopt all necessary legislation to implement Security Council sanctions measures against the Taliban and designated terrorists and their supporters.¹⁵ Since 1999, the Council of Ministers has adopted several Regulations to comply with UN Security Council Resolutions requiring states to impose sanctions against designated international terrorists and to interdict the financial relationships between terrorists and third party financiers and businesses. In 2000, the Council of Ministers adopted Council Regulation (EC) No 337/2000 that implemented the requirements that member states adopt financial sanctions against the Taliban as required under Security Council Resolution 1267 (1999).¹⁶

In 2001, the EC Council adopted Regulation 467/2001¹⁷ that required further restrictive measures to be taken – including the freezing of assets – against the Taliban government in Afghanistan and Osama bin Laden and persons and entities associated with him, such as the Al Qaida organisation. After the Taliban regime fell in 2002, the EC sought to address some of these gaps by replacing Regulation 467/2001 with Regulation No 881/2002.¹⁸ Regulation 881/2002 implements the requirement in Security Council Resolution 1390 (2002) that states ‘freeze without delay the funds and other financial assets or economic resources of [designated terrorists], ... including funds derived from property owned or controlled, directly or indirectly, by them or by persons acting on their behalf or at their direction’.¹⁹ The Regulation also expands the list of designated terrorists beyond those affiliated with bin Laden to include many European terrorist groups (i.e., Real IRA and the Basque ETA).

These regulations together reaffirm a common EU position that the European Community will act within its competence to adopt financial sanctions at the Community level that will ensure that funds, financial

¹⁵ Council Common Position 1999/727/CFSP (15 Nov. 99)(recognising SC res 1267).

¹⁶ Council Regulation (EC) No 337/200 (14 Feb. 2000), implemented UNSCR 1267.

¹⁷ Council Regulation (EC) No 467/2001 (06 Mar. 2001), implemented UNSCR 1333 (2000), and replaced Council Regulation (EC) No 337/2000.

¹⁸ Council Regulation (EC) No 881/2002 (27 May 2002), replaced Council Regulation (EC) No 467/2001.

¹⁹ UNSC Res. 1390, art 2(a).

assets, economic resources or other related services will not be made available to designated terrorists. The Regulations expressly require member states to adopt broad principles of liability to be applied to natural or legal persons who assist in the funding of terrorism. Specifically, Article 2 of Council Regulation 881 prohibits, except where a member state grants a licence, any person or entity from providing 'financial services to, or for the benefit of, a natural or legal person, group or entity' that is designated as a terrorist. Article 3 prohibits the knowing or intentional participation in activities, which have the object or effect of circumventing the restrictions set forth in Article 2. Article 4 provides a list of disclosure obligations for banks and other financial institutions, including insurance companies, regarding suspicious accounts and the amount held or controlled by suspect persons and to co-operate with other EC member authorities and the Commission in ensuring that these requirements are effectively enforced. Article 9 allows member states to determine the precise scope of sanctions (civil and/or criminal) to be imposed where provisions of the Regulation are infringed. Sanctions must be 'effective, proportionate and dissuasive'. In addition, Council Regulation (EC) 561/2003 was adopted in 2003 to implement the requirements of Security Council Resolution 1452 that allow certain exemptions for humanitarian expenses to be paid in the sanctions programmes under Security Council Resolutions 1267 and 1390 against the Taleban and Al Qaida. In 2005, the European Commission issued a Communication that identifies best practices to strengthen coordination among all relevant national authorities in combating terrorist financing with a special emphasis on enhanced information exchange between authorities and private sector actors.

In 2008, the Court of Justice of the European Communities upheld a number of claims on appeal seeking annulment of Council Regulation 881/2002 by individuals and entities whose assets had been frozen by EU states because they had been designated as terrorist supporters by the Security Council's Al Qaeda/Taliban sanctions committee.²⁰ The Court ruled that the Council had no legal competence to rely on Articles 60, 301, and 308 of the EC Treaty to impose economic and financial sanctions against non-state actors (as opposed to third party states), such as 'associated persons, groups, undertakings or entities developing international terrorist activity or in any other way striking a blow at international peace and security.' Although the ECJ held that the Community was bound by the paramountcy of United Nations law, the Council could nevertheless only take measures to implement UN law that were based on authority granted by the EC Treaty. This ruling will have an important effect on EU sanctions

²⁰ See *Yassin Abdullah Kadi and Al Barakaat International Foundation v. Council of the European Union*, C-402/05 and C-415/05 P (joined cases) Judgment of the Court Grand Chamber (3 Sept. 2008).

practice against non-state actors, such as terrorists, and potentially disrupt the development of a common foreign and security policy for the EU regarding anti-terrorism policy.

IV Legal and regulatory obstacles to implementation

Most systems of criminal and civil law are territorially based in a theoretical and administrative sense and therefore are ill suited to attack the transnational operations of terrorist operations which utilise a vast and complicated network of international transactions so that the strict application of the basic rules of domestic jurisdiction fail to do justice in many cases.²¹ As discussed above, Resolution 1373 requires UN member states to freeze all the assets of designated terrorist groups and entities supporting such terrorists within the jurisdiction of each member state and according to its legal principles. Because the method of designating terrorist groups varies by state and the legal principles by which financial sanctions are imposed varies by state, serious disparities arise concerning the extent that financial sanctions will apply and the legal protections, if any, of those who are accused of supporting – either directly or indirectly – designated terrorists. Moreover, the system of designating terrorists and terrorist support groups varies between countries and is often based on intelligence derived from covert operations, which ordinarily cannot be divulged in judicial or tribunal proceedings. As in previous UN sanctions programmes, the Counter-Terrorism Committee (CTC) has not applied uniform standards in these areas, and because it has required member states to recognise the freeze orders of other member states directed at particular individuals or groups accused of terrorism without providing any international standards to guarantee that such sanctions are not being imposed in an arbitrary and capricious manner, much dispute has arisen amongst major states with respect to whether such orders should be given mutual respect if issued without adherence to basic human rights.

Although the CTC and its Executive Directorate's (CTED) co-ordination of the implementation of Resolution 1373 has had significant impact in exposing and restricting various aspects of terrorist financing and has fostered a degree of co-operation amongst states in addressing terrorism, the ultimate effectiveness of such sanctions will depend on the ability and willingness of national authorities to enforce them. For instance, national authorities must ensure that economic sanctions are not evaded by multi-national holding companies composed of shell corporations and other sophisticated financial

²¹ As the case of the Bank of Commerce and Credit International (BCCI) indicated, structuring the various corporate entities of an international bank in offshore jurisdictions is relatively easy for purposes of avoiding the scrutiny of national regulators. See Bala (1994, 823) discussing the BCCI international banking network and the failure of US regulators to discover fraud.

entities. Moreover, although each member state is permitted to implement and enforce sanctions according to its own legal principles, there should be a fair degree of commonality in how authorities define civil and criminal liability for breaching sanctions laws. Targeted entities should have basic protections against having their assets frozen or confiscated without due process of law. When one country's legal authorities violate such protections, other national authorities often become reluctant to co-ordinate transnational investigations and enforcement efforts. Indeed, the methods to implement the war against terrorism may clash with basic international human rights (Cameron, 2005). Moreover, issues of extra-territorial jurisdiction and third party liability may take on different dimensions in different legal systems, thus thwarting the efficient implementation of international sanctions.

Since the regulation of companies and financial markets has traditionally been territorially based, terrorists groups have been successful in building global commercial networks to generate resources that support international terrorist activity. They do this by owning and controlling groups of companies and financial institutions based in different countries and in poorly regulated offshore jurisdictions to support and facilitate acts of terrorism that often occur in multiple jurisdictions. For these regulatory controls to be effective in today's globalised economy, they must have a jurisdictional basis that is not restricted to the geographic territory of the regulating state.

But it should also be noted that an effective policy of extra-territorial controls must be precisely defined and co-ordinated in its application with foreign authorities. Otherwise, the objective of incapacitating the transnational organisational structure of terrorism will not be accomplished. International co-operation and co-ordination amongst national authorities in implementing expansive principles of extra-territorial jurisdiction is an essential component in devising an effective international legal strategy. The experience of the United States in relying primarily on a unilateral and extra-territorial approach to applying economic and financial sanctions demonstrates that even the substantial economic influence of a superpower can prove ineffective in combating global threats to stability without the co-operation of and co-ordination with other national authorities. Although the extra-territorial provisions of the Patriot Act regarding 'long-arm jurisdiction' over foreign money launderers and strict disclosure requirements for offshore banks that utilise the US financial system will plug some glaring loopholes in US law, it will have at best a minimal impact on controlling the international aspects of terrorist financing unless other major national regulators are co-operating and applying similar standards in their own jurisdictions.

The global dimension of the financing of international terrorism has become the target of multilateral financial sanctions. It must be attacked on a number of fronts including improved intelligence collection and analysis, enhanced supervision and regulation of financial markets, transparency in the offshore activities of companies and financial institutions, improved cultural and social understanding and effective cross-border investigations and

enforcement. The legal issues and legislation discussed above are significant because they recognise the importance of attacking international financial crime and terrorist groups by imposing economic controls on third party companies, financial institutions, and professional advisers who are often responsible for providing direct and indirect support for the financing of terrorism. To the extent that there is a need for increased reliance on extra-territorial measures to interdict terrorism and its financing, it must be co-ordinated at the international level and there must be some equivalence in political will by national authorities to enforce such measures. Otherwise, the war against international terrorism might prove ineffective and serve only those who seek to undermine the stability of the international political system.

Regarding the scope of jurisdiction to be applied to terrorist offences, the complexities of modern technology and the forces of globalisation necessitate that each state adopt uniform jurisdictional principles with respect to international sanctions enforcement that recognise expansive concepts of extra-territorial jurisdiction. For example, extra-territorial jurisdiction should be recognised when at least one element of the offence of financing terrorism occurs inside the territory of the enforcing state. At present, too few states recognise expansive notions of extra-territorial jurisdiction for civil and criminal offences involving international terrorist activity. The extension of extra-territorial jurisdiction, however, should only be done within a multilateral framework of co-ordination and mutual recognition of harmonised jurisdictional practices amongst states.

It should be recognised, however, that disparities between countries in the sophistication of their legal systems and in administrative and technical skills will make the objective of accomplishing more uniform standards to implement the requirements of Resolution 1373 difficult, if not impractical, for many countries. Indeed, by merely adopting more uniform legal principles and enforcement procedures, especially with respect to issues of extra-territorial jurisdiction, third party liability, and the precise definition of the offence of financing terrorism, a more uniform and efficient international enforcement regime will likely not emerge because of the lack of uniform national implementation due to disparities in administrative expertise, technical skills and legal infrastructure. Notwithstanding these obstacles, there is an emerging consensus that if the United Nations and other international organisations provide assistance in administrative and technical support for developing countries and emerging economies so that they can implement the necessary economic controls, then the adoption of more harmonised legal principles and enforcement procedures will lead to a more effective international sanctions regime.²²

²² For example, both the Al Qaida/Taleban and Counter-Terrorism Committees (1267 & 1373) have established programmes to provide administrative and technical support for countries lacking the necessary regulatory controls and legal infrastructure to attack terrorist financing. For instance, the Security Council adopted resolution

Regarding third party liability, Resolution 1373's requirement that each state become a party to the 1999 Terrorist Financing Convention obliges each state to adopt specific criminal offences that prohibit direct and indirect commercial or financial support for terrorist activity. In many country reports, a major issue of concern has been the precise definition of the financing of terrorism. Some states argue that they need not take any further legal measures to make terrorist financing a criminal offence because it is already outlawed by the criminal law on *aiding and abetting*. Other state reports explain that the existing offence of conspiracy in many jurisdictions already covers the offence of financing terrorism. The experts committee has stated, however, that the auxiliary offence of *aiding and abetting* will not, without more, properly implement sub-paragraph 1(b) of the Resolution, which requires each state to criminalise direct or indirect support for the financing of terrorism. They also take the view that a state's reliance on the conspiracy offence alone is insufficient to comply with the Convention, because the Convention requires states to criminalise the financing of terrorism, regardless of whether it is committed by one or more persons.

Moreover, many states have reported that the requirement in paragraph 1 (b) of resolution 1373 that each state criminalise the financing of terrorism has already been covered by existing national anti-money laundering legislation and other criminal statutes. The Committee has taken the view that, while money laundering and the financing of terrorism are often inter-related, these crimes are not identical. This is because money laundering can be defined broadly to mean 'the processing of criminal proceeds to disguise their illegal origin'. By contrast, the financing of terrorism often involves moneys that are not necessarily derived from illegal sources, but which are nevertheless used to fund terrorist activities. For instance, assets and profits acquired by legitimate means, and even declared to tax authorities, can be used to finance terrorist acts. Moreover, as discussed above, these proceeds can be generated not only by legitimate businesses but also by donations to charitable, social or cultural organisations, and then diverted from its intended or stated purpose to fund terrorist acts.

The role of the financial sector and its regulation are crucial in developing an effective economic sanctions programme. The freezing of assets depends heavily on suspicious transaction reports by banks to regulators and supervisors. The Terrorist Financing Convention, however, requires states to make not only banks subject to reporting requirements, but also any other commercial firm or professional adviser (i.e., lawyers and accountants). This why the experts committee has urged states to require third party professionals to be subject to suspicious transaction reporting requirements as well. Moreover, the Financial Action Task Force now requires all states to expand the predicate

1535 in 2004 that created the CTC's Executive Directorate, which has responsibility for providing technical assistance to countries to implement CTC anti-financing restrictions and to promote cooperation with other UN organisations and with regional and inter-state bodies.

offence for money laundering to include acts of terrorism. Also, banks are required to interdict financial transactions in which the proceeds derive from lawful activity, but which go to support designated terrorists.

Experts committee reports have also observed that a number of states are failing to make clear distinctions between the freezing, seizing and confiscation of assets. A further point of concern regards the failure of most states to address the issue of informal banking networks used to finance terrorist activity and the need for national authorities to adopt more effective regulatory strategies. Indeed, the G-20²³ at its meeting in Ottawa in November 2001 resolved to broaden its agenda to address the challenges posed by international terrorism and agreed on an Action Plan to combat terrorist financing. In addition to the requirement that there be a comprehensive criminalisation of terrorist financing, there is also the issue regarding the prosecution or extradition of terrorists. Regarding prosecution, the expert committee has criticised state reports that by and large omit any mention of state measures taken to deny safe haven to the supporters of terrorism as requested by the Counter Terrorism Committee's guidance note that refers to obligations in sub-paragraph 2(c) of resolution 1373. Regarding extradition, paragraph 3 of the Resolution requires inter-state co-operation in administrative matters regarding investigations, enforcement, and judicial co-operation. In these areas, many states rely on the International Criminal Police Organization (INTERPOL) and the National Central Bureaus (NCBs), which act as liaison between the various national law enforcement authorities.

Some states have raised the issue of basic human rights protection for those designated as terrorists or as financiers of terrorists by the Al Qaida/Taleban committee or by a national authority under Resolution 1373, in which case it has been argued that the Security Council's practice of requiring all states to give mutual recognition to the terrorist designation orders of other states without providing evidence of terrorist activity has resulted in injustice for both accused terrorists and for their alleged supporters who in some cases have been shown not to have been involved in any terrorist activity. Indeed, those accused of terrorist activity or involvement should have basic protections against having their assets frozen or confiscated without due process of law. There is a growing view that the existing system of international sanctions enforcement undermines the legitimacy of the United Nations sanctions regime. The existing regime permits a state to designate individuals or entities as terrorists or terrorist supporters without due process of law. This

²³ Members include: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Korea, Turkey, the United Kingdom, and the United States. In addition, the finance minister of the country holding the rotating presidency of the European Union, the President of the European Central Bank, the Managing Director of the IMF, the President of the World Bank, and the chairpersons of the IMF and World Bank also attend these meetings.

has been the case in the United States where the Office of Foreign Assets Control (OFAC) can issue freeze orders that must be implemented immediately by US-controlled banks and commercial entities in their worldwide activities unless the accused terrorist persuades OFAC in a non-public hearing before an OFAC enforcement officer (without an administrative judge) that they are not involved in terrorist activity (Fitzgerald, 1999). In the United Kingdom, by contrast, courts have been more sympathetic to petitions from individuals whose assets have been blocked under both the Al Qaida/Taleban sanctions and the Resolution 1373 sanctions and from third parties who have made resources available to designated terrorists.²⁴ Some countries' courts have become reluctant to recognize and enforce asset blocking orders when it appears that other countries failed to ensure due process and human rights considerations when issuing such orders. Indeed, the methods to implement the war against terrorism may clash with basic international human rights.

The Swedish and French governments raised the issue of human rights protection with the Security Council in January 2002 in a case involving whether Sweden and France were required to recognise certain freeze orders issued by the US government's Office of Foreign Assets Control (OFAC) against three Somali-born Swedish citizens whom the US had designated as terrorists in the aftermath of the 11 September attacks. The Swedish and French governments sought to highlight the issue of the rule of law and the protections, if any, which individuals or businesses were entitled to when confronted with asset freeze orders issued by foreign governments that were acting within the legal framework of the UN sanctions committee. The US had transmitted its terrorists list to the Security Council's Al Qaida and Taleban Committee, and the committee had required that member states freeze the assets of the designated terrorists.

The Swedish government froze the accounts of Abdirisak Aden, Abdulaziz Abdi and Yusaf Ahmed Ali, on the grounds that US intelligence claimed they had provided financial support to Al Qaida. The alleged terrorists contended that they had only transferred money to their families in Somalia. The Swedish government requested information from the US government in order to determine whether the alleged terrorists were actually involved

²⁴ As discussed in Chapter 4, the Court of Appeal overruled a UK High Court decision in *A, K, M, Q & G v. HM Treasury* [2008] EWHC 869 (Admin 2008) striking down both the UK Terrorism (United Nations Measures) Order 2006 (2006 No. 2657) (SC Resolution 1373) and Al Qaida and Taleban (United Nations Measures) Order 2006 (2006 No. 2952). The Court of Appeal upheld the freeze orders so long as the designated parties have the opportunity to make judicial challenge on the merits or by way of judicial review and that UK authorities must show that there was reasonable cause to believe the parties to be involved in terrorist financing. In another case, the UK House of Lords has made a reference to the Court of Justice of the European Communities of a UK Treasury measure that requires third parties who provide economic resources to a designated terrorist to file reports to the Treasury as *ultra vires* under the relevant EU.

in terrorist financing. The French government also intervened by urging the Security Council to review the Al Qaida and Taleban sanctions list and to establish some basic rules for enforcing anti-terrorist financial sanctions that would include specific criteria to impose sanctions, such as a direct link with Al Qaida or the Taleban, and a procedure for regularly reviewing the list. The US government opposed the Swedish request and the French government proposal because in its view divulging such information might threaten national security by endangering the ability to gather intelligence (Schmemmann, 2002, A7).

The three defendants complained that their assets were frozen without opportunity to contest the charges. The financial sanctions imposed by the Swedish government were broad in that they restricted cash payments by the defendants for legal fees and prohibited Swedes from contributing to their legal defence. Their case became a *cause celebre* with a prominent Swedish lawyer, Leif Silbersky, providing their legal defence. The Swedish ambassador to the United Nations asked the Al Qaida and Taleban Committee to review the defendants' inclusion on the sanctions list. The Swedish government raised the concerns because the freeze order emanated from the US Treasury Department whose authority to designate terrorists and to freeze their assets derives from a presidential order that is based on authority found in the International Emergency Economic Powers Acts of 1977. US courts have ruled that executive orders to impose financial sanctions are subject only to the most limited judicial review. The Swedish government was therefore concerned about the factual basis and reviewability of the US freeze order before a court. As mentioned above, when the US government refused to disclose any facts that would serve as a justification for its and the Swedish government's freeze order, the Swedish court rejected the freeze order as a violation of article 6 of the European Convention on Human Rights that requires a hearing before a fair and impartial tribunal before depriving an individual of its rights.²⁵ Similarly, the French courts invalidated the freeze orders that were imposed by the French government based on the designations of the Al-Qaida and Taleban committee.

In summary, there are two different UN approaches to interdicting the financing of terrorism. The 1267 regime requires all states to identify and freeze the assets of those persons designated by the 1267 Committee. However, Resolution 1373 requires states to make the identification themselves and recognise the designations of other states. Because there is no agreed common definition of terrorism at the United Nations, there are concerns that governments may use the 1373 process to designate domestic political opponents as terrorists and to seek international recognition of their designation.

²⁵ These cases show that foreign governments should examine closely the factual basis of any US freeze order against an alleged terrorist or other targeted person.

Although there is a de-listing procedure for erroneous designations of Al Qaida and Taleban supporters, the process for de-listing is inadequate for Resolution 1373 designations because the listing process is controlled by domestic authorities. For instance, the United States has a database with over 330,000 names and entities suspected of being terrorists or supporting terrorists, and the US has blacklisted over 60,000 individuals and entities around the world. Many of these individuals have been designated by the US government as terrorists and have had their assets frozen and the US seeks recognition of these designations through the 1373 Committee so that these designations can be recognised and enforced in the UK, Europe and other countries.

Financial Action Task Force

The extension of international sanctions to non-state actors, such as terrorists and terrorist organisations, makes it necessary to consider the role of other international institutions, such as the Financial Action Task Force (FATF), in developing international standards to combat terrorist financing. FATF has emerged as a major player in setting international standards to combat financial crime (Gilmore, 2003). FATF was established by the G-7 Heads of State in 1989 at the G-7 Summit. FATF is the only international body with the primary objective of fighting money laundering and other aspects of financial crime including terrorist financing. Its membership includes all the major developed countries and some developing and emerging market states.²⁶

In 1990, FATF issued Forty Recommendations on money laundering countermeasures intended to constitute an international 'minimal standard in the fight against money laundering'.²⁷ The Forty Recommendations prescribe a range of actions designed to improve national legal regimes, enhance the role of the financial system and regulatory practices, and strengthen international co-operation against financial crime. The Forty Recommendations are not legally enforceable on FATF members. This is

²⁶ FATF's membership reflects the membership of the Organisation for Economic Cooperation and Development, which includes thirty members as of May 2008: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States. In May 2007, OECD countries agreed to invite Chile, Estonia, Israel, Russia, and Slovenia to open discussions for membership and offered enhanced enlargement, which could lead to membership, to Brazil, China, India, Indonesia, and South Africa. The FATF Secretariat is located at the OECD.

²⁷ See Directorate for Financial, Fiscal and Enterprise Affairs, Organisation for Economic Cooperation and Development, FATF VII Report on Money Laundering Typologies 23 (1996).

intended to give national authorities maximum flexibility and control in implementing international standards into national legal systems. In response to the events of 11 September, FATF convened an extraordinary plenary meeting in October 2001 with the objective of expanding its mission beyond money laundering and financial crime to include the financing of international terrorist activity. At this meeting, FATF called on all countries to adopt and implement newly issued FATF 'Special Recommendations' intended to deny terrorists and their supporters access to the international financial system. Subsequently, FATF members adopted Nine Special Recommendations on Terrorist Financing that have become the international standard for how countries can regulate their financial institutions in a way that reduces exposure to terrorist financing. FATF members take the view that the 'Special Recommendations' on terrorist financing, combined with the FATF Forty Recommendations on Money Laundering, establish the basic framework for detecting, preventing and suppressing the financing of terrorism and terrorist acts.

Special Recommendation I states that 'each country should take immediate steps to ratify and to implement' the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism and to implement immediately the UN resolutions relating to the prevention and suppression of the financing of terrorism, particularly the UN Security Council Resolution 1373 that was adopted on 28 September 2001. Special Recommendation II urges each country to criminalise the financing of terrorism and associated money laundering.

Equally important, Special Recommendation III requires each country to implement measures to freeze funds without delay or other terrorist assets, and those intermediaries or other third parties who finance terrorism or terrorist organisations should be defined as such in accordance with the United Nations Resolutions relating to the prevention and suppression of the financing of terrorist acts. In addition to freezing assets, Recommendation III urges countries to adopt and implement measures (including legislative ones) that authorises the competent national authorities to seize and confiscate property defined as the proceeds of, or used in, or intended or allocated for use in, the financing of terrorism, terrorist acts or terrorist organisations. This provision appears to allow each country to define what property is considered to be the proceeds of terrorist activity. More important, the FATF Recommendations omit any definition of terrorism and appear to allow member states to adopt a definition under their local law. Special Recommendation IV urges each country to adopt effective regulations that require financial institutions and other business entities subject to anti-money laundering obligations to report promptly to national authorities any suspicious transactions or accounts that may be related to terrorism.

In January 2002, FATF stated that it would engage all countries, including non-FATF members, in a self-assessment process to ensure that FATF and

non-FATF members adopt effective regulatory measures to reduce terrorist financing in their respective jurisdictions. Since 2002, FATF members have reiterated these policy and regulatory aims at their annual meetings.²⁸ FATF efforts in this area, along with the continued engagement by many national authorities with other international bodies and organisations, seek to marginalise terrorist financiers by bringing the global financial system under surveillance. To this end, the 'Special Recommendations' supplement and reinforce the measures already adopted by the UN and create a more comprehensive international regime for interdicting the financing and commercial support of terrorists and terrorist activities.²⁹

The non-binding nature of FATF standards however has been called into question in recent years because FATF has on several occasions threatened to impose sanctions against states deemed by FATF as having failed to adopt national legislation to implement the Forty Nine Recommendations. FATF's threat to use sanctions has in most cases resulted in targeted states and jurisdictions adopting the necessary legal and regulatory measures to implement FATF standards. In recent years, however, FATF has resorted less often to the threat of sanctions and has instead utilised behind the scenes political pressure to bring states into compliance.

As part of the fight against international money laundering, the OECD countries acting through the FATF created the Financial Intelligence Units (FIUs) network. The FIUs are specialised national agencies designed to attack financial crime in its various modes through the exchange of information, sharing of expertise, and other forms of co-operation. The annual meetings of FIUs began in 1995 at the Egmont-Arenberg Palace in Belgium and today are known as the Egmont Group.

The global network of information exchange and co-operation established by the Egmont Group has been a valuable and responsive avenue through which to exchange terrorist-related information. Indeed, the US Financial Crimes Enforcement Network (FinCEN) hosted a special meeting of the Egmont Group on terrorist financing in October 2001 to explore ways to support multi-lateral efforts to combat terrorist financing. During the special meeting, the Egmont Group agreed to: (1) review existing national legislation to identify and eliminate existing impediments to exchanging information between FIUs,

²⁸ FATF Chairman's summary of FATF Plenary, 23 February 2007. See <http://www.fatf-gafi.org/dataoecd/28/6/38164024.pdf> (last visited 1 February 2008).

²⁹ A Ninth Special Recommendation was adopted by FATF in October 2004 that calls on countries to stop cross-border movements of currency and monetary instruments that relate to money laundering and terrorist financing and to confiscate such funds. See FATF, Press Release, 'FATF Targets Cross-Border Cash Movements by Terrorists and Criminals' (on file with author). It also calls on countries to enhance mutual assistance and sharing of information related to cross-border movement of cash.

especially when such information concerns terrorist activity; (2) encourage national governments to make terrorist financing a predicate offence to money laundering and to consider terrorist financing a form of suspicious activity of which financial institutions should be aware; (3) facilitate information requests from other FIUs and ensure that information passed in the FIU system does not leak to other government agencies; (4) and pool Egmont resources, where appropriate, to conduct joint strategic studies of money laundering vulnerabilities, including the Hawala underground banking system.

The recent efforts taken by international and regional organisations, along with the support of national authorities, have achieved a significant level of consensus in devising international regulatory standards to combat the financing of terrorism and weapons proliferation. Indeed, the events of 11 September have served as a catalyst for national regulators to extend further their co-operation and co-ordination in imposing financial sanctions that include, among other things, the movement of funds and transfer of assets that are owned or controlled by designated terrorist groups. The extensive level of mutual support that has arisen has resulted in a specific set of international norms and rules embodied in the FATF standards that require states to implement the necessary regulations in their respective jurisdictions mandating minimum levels of disclosure and transparency for financial institutions and other commercial enterprises or individuals who are involved in suspicious transactions with terrorist groups. These international standards can potentially be viewed as legally binding in a customary international law sense, as their breach could potentially result in economic sanctions applied against the non-complying state by such bodies as the FATF or even possibly the Security Council, or by national regulators acting in a unilateral manner (i.e., US extra-territorial sanctions). The new international regime that utilises financial sanctions to target terrorist financing has emerged as a principal area of regulatory concern for commercial and financial enterprises that operate transnationally, or conduct transactions involving foreign enterprises or individuals.

The global reach of the new international regime will make it difficult for market participants to conceal their activities in offshore jurisdictions with opaque regulatory standards that are beyond the reach of regulatory scrutiny. Although there was a concern that the extensive global reach of the FATF and the Security Council sanctions regime would merely drive most of the terrorists' commercial and financial operations underground, it has succeeded on many fronts in exposing and interdicting the sources of terrorist financing and adding more transparency to financial transactions and in fostering more regulatory co-ordination between national authorities. Regardless of the success of the new regime in reducing the availability of the economic resources to terrorist enterprises, it will likely accomplish one of its goals: the elimination of terrorist financing from the formal banking

system. This objective, however, is only one part of a broader policy to interdict alternative terrorist financing networks and control the financing of nuclear weapons proliferation.

Enhancing the Security Council's role?

The UN Security Council and its sanctions committees play the major role in overseeing multilateral economic sanctions. Although some have called for the Security Council to be exclusive in the sanctions domain and to preempt the autonomy of states to impose sanctions,³⁰ this study suggests that the Security Council should delegate oversight and implementation of sanctions to more experienced economic and regulatory organisations, such as the FATF and World Bank. The Security Council would still play the leading political role in deciding to adopt international sanctions, but coordinating their implementation and developing international standards for their application should become the responsibility of international bodies which have expertise in advising countries on economic and regulatory issues. These bodies will play a key role by promoting convergence in economic sanctions practice that is similar to the role played by other international standard setting bodies, such as the Basel Committee on Banking Supervision which promotes convergence in bank regulatory practices among all states. Nevertheless, states should have discretion to adopt different legal techniques and regulatory practices in applying sanctions that take account of their different economic and institutional circumstances.

This approach recognises the reality that the present international regime of multilateral economic and unilateral sanctions should be considered within a broader context of maintaining international political order and enforcing important principles, norms and standards of state conduct that reflect the interests and preferences of nation states. This does not mean, however, that there is no room for reform of state sanctions practice and the international framework that governs it. As the existing framework is dominated by the permanent members of the Security Council and by the largely developed, western-oriented countries of the FATF/OECD, there is a need for more input in standard setting and in deciding how sanctions shall be implemented and enforced by a broader range of countries and jurisdictions presently subject to their application.

Conclusion

Since the end of the Cold War, economic sanctions have enjoyed a renaissance. This has been brought about in part by the growing liberalisation of the

³⁰ See comments of Sir Jeremy Carver, written evidence submitted to the House of Lords Select Committee on Economic Affairs, 'The Impact of Economic Sanctions', vol. 2 (9 May 2007).

global economy and advances in technology that have allowed states to extend the scope of their economic regulation and trade controls to cross-border transactions involving foreign parties and property. Indeed, in the post-11 September environment, the growing threat posed by international terrorists and by state sponsors of terrorism has given sanctions a renewed mission. The growing use of economic sanctions under the oversight of the UN Security Council suggests that sanctions can be used against a number of targets, and not simply against states as it was throughout much of modern history. This suggests that the Security Council has a vital role to play in using sanctions to promote international peace and security and that its increased sophistication in applying and monitoring the application of sanctions through a system of expert committees has produced beneficial results for enhancing the effectiveness of multilateral sanctions. Nevertheless, states are confronted with a number of policy challenges that make implementation of sanctions very difficult. Differences in legal doctrine and regulatory practice can result in different levels of effectiveness in implementing international sanctions mandates. The sanctions committees have not fared well in advising states on how to improve their legal techniques and regulatory practices for implementing sanctions. As discussed in Chapters 3 and 4, the committees have failed to agree on basic legal doctrines and regulatory practices that can support the application of sanctions. The accountability and legitimacy of a sanctions programme depends on their application being grounded in certain principles that include proportionality, discrimination and necessity.

Moreover, economic theory has an important role to play in determining what type of sanctions measures states should adopt. The adoption of sanctions is for most states costly and should be informed – at least with respect to export sanctions – by the theory of comparative advantage as discussed in chapter two. Moreover, different legal and regulatory frameworks across countries necessitate different legal techniques and regulatory approaches to implementing sanctions. Flexibility and diversity of approach is essential for enhancing their effectiveness. The Security Council sanctions committees, however, are overly concerned with uniform implementation and imposing the same requirements on each country with little regard for their economic capacities and legal frameworks at the national level. Technical assistance is necessary to conduct these assessments and the expertise necessary to perform these functions is not in the Security Council, but rather in traditional international economic development organizations, such as the World Bank and regional development banks. By involving specialists from these organizations and other economic policy experts to advise countries on appropriate implementation strategies, the effectiveness of economic sanctions can be enhanced.

In recent years, national security policy has been dominated by the challenge of how to restrict economic activity with terrorist groups and their supporters. The internationalisation of commercial and financial markets

has resulted in major challenges for national regulators and enforcement agencies to trace and interdict the financing of terrorism. This chapter examined the role of international institutions and how anti-terrorist financing measures have become central components of most states economic sanctions policies. Although these multilateral arrangements are the result of unprecedented co-operation and co-ordination in devising and implementing financial sanctions at the national and international level, serious obstacles have arisen regarding how to implement international financial restrictions into domestic law and regulation and the difficult process of identifying and blocking the assets of alleged terrorists without infringing on human rights. Although the Security Council counter-terrorism committees have taken the lead in facilitating the mutual recognition of blocking orders and travel bans by states, serious concerns regarding human rights and due process of law have arisen regarding the application of anti-terrorist financing laws. The concerns with human rights and other rule of law issues have caused a growing number of courts – mainly in European jurisdictions – to disapply certain asset freezes and financial sanctions. The challenge for public policy will be to reconcile and balance competing interests and rights in order to devise effective sanctions instruments while respecting individual rights which may be interpreted differently across countries. How to strike this balance will vary between countries but should be informed by the overall objective that sanctions measures should be robust in attaining their objectives, yet not a serious infringement of fundamental legal rights, nor unrealistic for a country's economy to adopt.

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