U.S., EU, AND UN SANCTIONS

Navigating the Divide for International Business

CHAPTER 1.
INTRODUCTION—
THE GOLDEN AGE OF SANCTIONS

Adam M. Smith
Stephanie L. Connor
Richard W. Roeder

Gibson, Dunn & Crutcher LLP

Bloomberg Law®

Arlington, VA

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CHAPTER 1.
INTRODUCTION—
THE GOLDEN AGE OF SANCTIONS

A. "An Unabashed Failure" to War by Another Means

Sanctions have become a ubiquitous policy tool, suggested as a "solution" to international and domestic crisis as varied as terrorism, corruption, and illegal immigration, and implemented by a range of jurisdictions; the United States remains the most enthusiastic purveyor of the tool, but Washington is being followed closely by policy makers in Brussels, London, Riyadh, Moscow, and Beijing.[1] Despite this, it is worthwhile remembering that it was not that long ago—and well into the early 2000s—that scholars and policy makers viewed sanctions as a broad-based failed tool of statecraft, often more likely to hurt policy objectives than to achieve them and increasingly apt to harm innocents rather than to exert pressure on their intended targets. How did we get here?

It is hard to overstate how little the academic and policy making communities believed in the power of sanctions. The titles of the books and articles—let alone their contents—are very clear in their dismissal of the instrument.

[1] This treatise is of informatory nature only and it is not intended to provide legal advice, and no legal or business decision should be based on its content. Sanctions are in constant flux. We thus appreciate any comments, questions, and suggestions you might have. Please do not hesitate to reach out to the authors in case you have any questions, queries, or suggestions. Gibson Dunn also regularly provides updates on recent developments. If you are interested to receive those, please let us know and we shall add you to the respective mailing list.

There was "Sanctioning Madness,"[2] "Economic Sanctions: Too Much of a Bad Thing,"[3] and "U.S. Economic Sanctions: Good Intentions, Bad Execution."[4] The conventional wisdom, backed up by complex econometric studies and borrowing from the work of political scientists, game theorists, and philosophers, was that sanctions "worked" (defined differently in different studies) no more than one-third of the time. Indeed, the conventional wisdom held that sanctions could not work any more often because of the nuances of how states were organized and the fundamental bias in states towards survivability. That is, no matter the economic harm incurred, a state backed into a corner could not possibly be compelled towards a policy outcome that could lead to (or that necessitated) its demise or that even called into question a bulwark of its self-definition. To get that outcome, sanctions were fundamentally ineffective and the only tool available was the most ancient—occupation and subjugation by armed force.

Indeed, the effectiveness of sanctions is far from a settled issue. Many scholars have argued that the cessation of commercial activity has rarely been a decisive, or even important, factor in bringing hostilities to an end.[5] Scholars on this side of the argument point to examples of where sanctions policies have failed, such as the fact that Germany continued building planes, tanks, and submarines despite a complete embargo during World War II and the Castros' decades-long control of Cuba despite U.S. sanctions.[6] With the increasing interconnectedness of the global economy, it has become increasingly easy for targeted countries to find alternate suppliers, financial markets, and financial backers to replace embargoed goods or withheld funds.

Another common critique of sanctions is that they are often inconsistent with the ideals of the World Trade Organization (WTO) and free trade obligations. However, despite their incompatibility at first blush, sanctions and fair trade cannot only be compatible, but sanctions can help facilitate free trade. Although sanctions may appear to inhibit trade in the short term, they can help in the long run when effective as trade liberalizers. Economic sanctions were used to combat Nazism, Communism, terrorism, and other threats, and to the extent they thwarted such threats, they contributed to the creation of conditions favorable to the spread of globalization and free trade.[7]

Defenders of the use of economic sanctions point to the fact that the founders of the General Agreement on Tariffs and Trade (GATT), and its successor, the WTO, deliberately left room for members to have recourse to enact sanctions where a nation's security was at stake.[8] This is evidenced by Article XXI of

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[2] Sanctioning Madness, *available at:* https://www.foreignaffairs.com/articles/1997-11-01/sanctioning-madness.

[3] Economic Sanctions: Too Much of a Bad Thing, *available at* https://www.brookings.edu/research/economic-sanctions-too-much-of-a-bad-thing/.

[4] U.S. Economic Sanctions: Good Intentions, Bad Execution, *available at* https://piie.com/commentary/speeches-papers/us-economic-sanctions-good-intentions-bad-execution.

[5] Donald E. deKieffer, *The Purpose of Sanctions*, 15 CASE W. RES. J. INT'L L. 205, 205 (1983).

[6] *Id.* at 205–06.

[7] David A. Baldwin, *Prologomena to Thinking about Economic Sanctions and Free Trade*, 4 CHI. J. INT'L L. 271, 280 (2003).

[8] Maarten Smeets, *Conflicting Goals: Economic Sanctions and the WTO*, 2 GLOBAL DIALOGUE 10 (Summer 2000).

GATT, which states, "[n]othing in this Agreement shall be construed . . . to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests."[9] "Essential security interests" are not defined by GATT and are left to the judgment of WTO members.[10]

Regardless of one's view on the efficacy of sanctions, the risks of sanction overuse is real. Sanctions can strain diplomacy, cause instability in the global economy, and put heavy burdens not only on the targets but also on companies in the U.S. and abroad. Overuse of sanctions may ultimately reduce their effectiveness. As former Treasury Secretary Lew stated:

> *While sanctions are a valuable alternative to more severe measures, including the lawful use of force, it is a mistake to think that they are low-cost. And if they make the business environment too complicated—or unpredictable, or if they excessively interfere with the flow of funds worldwide, financial transactions may begin to move outside of the United States entirely—which could threaten the central role of the U.S. financial system globally, not to mention the effectiveness of our sanctions in the future.*[11]

What changed the mindset against sanctions and led policy makers back to this tool was a confluence of several factors that began in the days immediately following the Cold War and found a major inflection point after 9/11. Of all the impacts of the end of the Cold War one of the primaryimpacts—posited perhaps too simplistically in Francis Fukayama's notion of the "End of History"[12] —was—the seemingly settled primacy of the West over all competitors. While Fukayama spoke primarily of the liberal order and political systems that seemingly no longer had any competitors,[13] he could have just as easily spoken of the economic system that throughout the 1990s further had cemented the New York-London duopoly as the co-capitals of the world's economic system. There were banks and financial players in many other parts of the world—but transactions of any real size were increasingly routed through New York or London and ever increasingly in U.S. dollars. The formalization of western economic hegemony went further—western (and, indeed, American notions) of proper financial and business dealings led to the formation of the financial action task force (FATF) in 1989 designed to combat money laundering and that same year the beginnings of what would become the OECD Anti-Bribery Convention.

This role, combined with the post-Cold War onset of hard power fatigue, the drawdown of U.S. forces in former frontline posts in Europe and the decrease in military spending all set the stage for the rise of sanctions after 9/11. The 9/11 attacks of course challenged Fukayama's End of History and one of his errors became clear—Fukayama was primarily concerned about states and

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[9] General Agreement on Tariffs and Trade, Article XXI(b).

[10] Smeets, *Conflicting Goals* at 11.

[11] Remarks of Secretary Lew on the Evolution of Sanctions and Lessons for the Future at the Carnegie Endowment for International Peace dated Mar. 30, 2016, *available at* https://www.treasury.gov/press–center/press–releases/Pages/jl0398.aspx (emphasis added).

[12] Francis Fukuyama, *The End of History?*, 16 THE NATIONAL INTEREST 3-18 (Summer 1989).

[13] *Id.* at 3 ("The triumph of the West, of the Western *idea*, is evident first of all in the total exhaustion of viable systemic alteratives to Western liberalism.") (emphasis in original).

organized governments. What he had underestimated was the rise of non-state actors—terrorists, money launderers, organized criminals, and weapons traffickers that may have found refuge in states but were often apart from organized systems. The conventional battle plans that were designed to arrest the movement of tanks across a modern-day Maginot Line were ineffective when addressing either the movement of funds between individuals bent on destruction or the dissemination of ideology that served to radicalize.

Very quickly after 9/11 policy makers realized that they were dealing with a war that at least in one important component was going to be fought with dollars and cents rather than bullets and tanks. In the United States, the Congress recognized this as well, quickly passing the PATRIOT Act and providing the President a suite of new powers to impose restrictions and sanctions on individuals, entities, and even countries that were harboring terrorists or allowing funds for terrorists to pass through their territories. The tools that were developed under FATF and the anti-bribery tools would soon be commandeered into the service of these goals as well.

The United States used its role at the United Nations to roll out sanctions on terrorists on a global scale and leveraged its own domestic agency—the once sleepy Cuba-focused agency headquartered in a dank federal building across the street from the Treasury Department—the Office of Foreign Assets Control (OFAC)—to be the tip of the spear. OFAC would develop such a suite of powers and abilities—principally to target individual bad actors—that in the later part of the Obama administration it came to be known as the U.S. President's favorite non-combatant command.

B. THE POLICY BENEFITS OF SANCTIONS—WHY ARE THEY USED SO FREQUENTLY?

While the seeds of the rise of sanctions can be seen in the geopolitical, political economy, and domestic policy realities and constraints faced by many countries since the end of the Cold War.these trends came into further relief in the days after the 9/11 attacks. . From the perspective of practitioners trying to understand why sanctions continue to be used—and what their trajectory may be—there are several characteristics of the tool that help explain why policy makers have increasingly opted to impose sanctions—ease of implementation, low direct costs, absent legal constraints, and flexibility of design and calibration.

First, and most importantly, sanctions are fairly straightforward to implement—both as an absolute matter and in comparison with other tools of coercion. In the U.S. system, most sanctions are promulgated pursuant to the International Emergency Economic Powers Act (IEEPA). This post-Watergate era legislation was ironically designed to hem in the President's authorities to impose sanctions by requiring seemingly arduous requirements before the Executive could act. In order to impose sanctions, the President needs to compose an executive order in which the White House declares a ''national emergency'' with respect to an ''unusual and extraordinary threat'' outside the United States which threatens the ''national security, foreign policy, or economy of the United States.'' While this formula appears burdensome—and indeed was designed to be—over time it has become anything but. None of the terms used in the legislation are defined and courts have made it clear that they will provide the President significant deference as to what makes a ''national emergency,'' what is or is not an ''unusual and extraordinary threat'' and what sorts of activities and behaviors actually threaten ''the national security, foreign policy, or economy of the United States.'' As such, the determinations that give

rise to sanctions in the United States are inherently political, not legal, judgments. For both Democratic and Republican Presidents, IEEPA has allowed a wide variety of issues and subjects to be deemed to merit sanctions, ranging from the clearly threatening like the development of weapons of mass destruction by Iran or North Korea, to the troubling but objectively unlikely to be actually threatening like the suppression of human rights in Venezuela.

Once an emergency is declared, the President's flexibility continues—it extends not just to the subject matter of the emergency but also to the bases (the "prongs") under which entities can be sanctioned. Presidents can choose to focus on specific behaviors (such as being involved in developing WMDs) or status (of being a part of a government involved in suppressing human rights or being owned by entity or individual that has been otherwise designated). Though IEEPA is limited with respect to what a President can actually do with the sanctions—limited to controlling aspects of property under U.S. jurisdiction—in practice this flexibility has seen the President impose everything from almost absolute restrictions on dealings with targeted property (via the Black List) to more minimal restrictions that require enhanced due diligence in dealings with certain targets or reporting requirements regarding such dealings. Finally, once designed the executive order that triggers IEEPA is also completely discretionary and the President can opt to impose new designations frequently or not at all; and, when the President does choose to designate the Administration can rely on classified information in order to sanction and need only meet a very modest standard of proof ("a reasonable basis to believe") in order to secure a designation. The President does not even have to provide any notice prior to designations. While other jurisdictions—including the European Union—employ different processes and legal bases to establish their own sanctions, as a practical matter they too share the feature of discretion, surprise, and policy (rather than legal) calls with the U.S. model.

The **second** attractive feature of sanctions for policy makers is cost. Most tools in the coercive diplomacy toolbox are very expensive and usually unattractive. Military force—which is the tool sanctions are often called upon in order to avoid deploying—is not just monetarily expensive but also politically costly given that deployments put lives on the line. This makes military interventions politically expensive as well. Other tools, such as covert action or diplomatic pressure are either also very risky or risk being ineffective all.

Not so for sanctions—which has an amazing characteristic of not directly costing the government anything—and indeed if one takes into account the massive fines that have been derived from the enforcement of sanctions one could even argue that sanctions are a net earner for the government. Moreover, misfiring in the process of a military deployment can be deadly; misfiring in sanctions has nowhere near the same potential devastation. Although the collateral consequences of over-sanctioning are real, they are usually more diffuse and harder to trace directly back to the sanctions tool (rather than, for example, economic mismanagement or corruption at the hands of the government, organization, or official being targeted by sanctions measures).

Third, unlike other tools of coercion there are very few, if any, legal constraints or doctrines that dictate how, when and for how long sanctions can be imposed. Whereas there are numerous bodies of international law and jurisprudence governing the use of force—in the form of International Humanitarian Law and domestic legal constraints—and lawyers deployed to debate and authorize appropriate use of force, there are no such constraints for sanctions. Even if sanctions are designed poorly, and even if they may cause harm and

injury to innocent parties, there remains essentially no legal bar to the use of such tools.

Indeed, the one frequently used legal argument is that sanctions are a form of restriction on trade which is prohibited under WTO and other rules. However, even here, practitioners underline that almost all trade rules include national security exemptions—as such, so long as sanctions are being imposed at least notionally in order to further or protect national security interests, they even arguably comply with international trade law.

Fourth, sanctions are very flexible. While to many observers sanctions remain synonymous with the broad embargos against Cuba and Iran more recent ''smart'' sanctions imposed against weapons proliferators, trans-national organized criminals or narcotics traffickers—in which individuals' assets are frozen but not those of their home jurisdictions, or those against Russia and Venezuela which have targeted only certain transactions or specified entities– illustrate how flexible and creative sanctions designers have become. Indeed, in the U.S. context, as noted above IEEPA explicitly allows this sort of flexibility. An executive order promulgated under IEEPA provides the President the power to impose almost any restriction on property linked to a sanctioned person that comes into the United States. IEEPA allows the President to ''investigate, block, reject, prevent, prohibit, condition or otherwise regulate any transactions in property or interests in property held by'' a sanctioned party. Anything associated with property is fair game. Indeed, if one adds the flexibility of the initial design of sanctions to the ability for sanctions regulators to provide exemptions in the form of licenses and interpretative guidance and to practice prosecutorial discretion with respect to managing sanctions that have been imposed the flexibility is enhanced even further.

The **result** of these four factors has been an increasing reliance on sanctions as a tool of first resort for policymakers, both in the U.S. and abroad. Towards the end of the Obama administration and then ever more into the Trump administration it was a rare foreign policy of national security crisis the response to which did not have a sanctions component. In addition to the traditional uses of sanctions, the tool was increasingly and aggressively deployed to fight corruption, human rights abuses, election hacking, and the misuse of cyber currencies.

C. THE RISE OF NEWLY EMBOLDENED SANCTIONS AUTHORITIES THROUGH THE WORLD

This diversity in sanctions approaches is exacerbated further not just by the rise of newly emboldened sanctions authorities through the world, but the increasing penchant for core jurisdictions to impose their own measures and counter-measures often explicitly to challenge U.S. dominance and policy making that employs sanctions. As such, we have seen the European Union respond to U.S. sanctions on Cuba and Iran with a blocking statute that illegalizes compliance by European Union actors with such measures. In Russia, we have seen the threat of criminal liability mooted in the Duma to be imposed against any entity in Russia that dares to comply with Washington's measures against Moscow. With the likely advent of Brexit and the continuing inability for the United Nations Security Council to speak with one voice on core, sanctions-related issues, the further splintering of authorities is set to continue.

While diversity in the global policy making space continues, the global judiciary is also increasing its activity in challenging sanctions actions and enforcement. A cottage industry, primarily in Europe, has developed in which

entities and individuals have frequently been removed from sanctions lists; even courts in the United States have become more active in commenting on (even if not yet formally questioning) sanctions actions and enforcement decisions imposed.

All of this uncertainty comes amidst a simultaneous increase in the appetite and aggressiveness for enforcement. Some European Union states now have criminal penalties and theoretically unlimited fines associated with violations of their sanctions regulations. In the United States, the once notional fact that sanctions liability can give rise to both civil and criminal liability has given way to the very real situation of individuals incarcerated for violating U.S. sanctions regulations.

D. SMART SANCTIONS

As many critics have observed, comprehensive sanctions can lead to unintentional consequences and create unintended victims. "Smart Sanctions" were seen as a possible solution to the collateral effects. During the 20th century the sanctions tactics that shut Cuba out of the global economy and curtailed the success of Iranian oil, saw the United States largely utilize a "one size fits all" approach in which there were only wholesale embargos on a nation's trade.[14] In recent decades, however, the United States has developed a "calibrated approach."[15] The United States developed an understanding of the transactions and business relationships that fuel each nation's economy, which allows for a specific, targeted sanctions regime that solely focuses on certain sectors or actors. These targeted regimes are known as "smart sanctions."[16]

Smart sanctions, unlike other available tools, allow for minimizing collateral damage, such as bad investments, undesirable economic and trade relations, and innocent citizens in the targeted country.[17] Another benefit is, by their very nature, smart sanctions are specially crafted based on the desired goal at issue in the targeted country and can be quickly adapted to new pressures and circumstances.[18] For example, measures used against Iran may not be effective to achieve the same goal in Burma due to different infrastructure and economies, or perhaps the efforts used against financial institutions were initially effective in Iran, but new developments require a different approach.[19] Smart sanctions allow for varying approaches to accomplish the end goal that can be adapted to current circumstances.[20]

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[14] Friedman, Uri, "Smart Sanctions: A Short History," Apr. 23, 2012, *available at* http://foreignpolicy.com/2012/04/23/smart–sanctions–a–short–history/.

[15] *Id.*

[16] *Id.*

[17] Daniel W. Drezner, "Sanctions Sometimes Smart: Targeted Sanctions in Theory and Practice," 13 INTERNATIONAL STUDIES REVIEW 96–108 (2011) http://fletcher.tufts.edu /~/ media/Fletcher/News%20Images/Drezner_sanctions.pdf.

[18] *Id.*

[19] Jose W. Fernandez, "Smart Sanctions: Confronting Security Threats with Economic Statecraft," U.S. Department of State, *available at* http://www.state.gov/e/eb/rls/rm/ 2012/196875.htm.

[20] *Id.*

E. IMPACT ON PRIVATE SECTOR ACTORS

This overview of a fractious, ever harsher sanctions environment puts immense strain on the private sector actors who are very much on the frontlines of sanctions. Indeed, what is often forgotten by sanctions practitioners is that sanctions in a real sense are outsourced foreign policy. Rather than asking government actors to devise and deploy coercive or persuasive measures, sanctions have the government devising tools that are deployed by the private sector in the service of complying with governmental dictates. The more complicated the sanctions environment and the more risk involved in getting it wrong, the more likely the rise of wanton de-risking becomes a reality. This in turn could dull the effectiveness of sanctions going forward as the more surgical approach of "smart sanctions" designed by experienced sanctions practitioners gives way to sanctions implementation at the hands of an increasingly and understandably nervous private sector that appears more like the embargos of old than the "smart sanctions" of the post-9/11 world.