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Extraterritorial U.S. Sanctions

Only Domestic Courts Could Effectively Curb the Enforcement of U.S. Law Abroad

Sascha Lohmann

The long reach of U.S. law affects persons, property, and acts around the world. In trying to shield EU-based individuals and entities with commercial interests from its adverse impact, European policy-makers have recently been exposed as more or less helpless. In order to pursue their strategic objectives more effectively, Europeans must not only focus on increasing strategic autonomy vis-à-vis the U.S. government. Absent a diplomatic agreement with the executive branch, they must also better utilize available channels of influence. One potential avenue would be to substantially support EU-based companies in domestic courts – both diplomatically as well as financially – in order to challenge the executive branch when enforcing U.S. law beyond borders. Only the judicial branch can effectively curb the extraterritorial application of U.S. jurisdiction.

Since the founding of the republic, the U.S. government has continuously asserted authority beyond its borders in the pursuit of economic, foreign, and national security policy objectives. Three main factors account for the extension of U.S. law to persons, property, and acts located or conducted abroad: Firstly, an ideological commitment to natural law expressed in a firm commitment to the sanctity of inalienable rights believed to transcend national borders. Secondly, a legal culture shaped by the experience of steady territorial expansion and domination — initially as a former frontier society, and later as a self-restrained occupying force after World War II. And, thirdly, an independent judiciary that enjoys wide latitude to determine the geographical scope of statutory law and its implementation through administrative regulations.

The extraterritorial reach of U.S. law derives from statutes enacted by Congress (prescriptive jurisdiction); regulations and rules administered by the administration (enforcement jurisdiction); as well as litigation in domestic courts (adjudicative jurisdiction). During the late 18th and early 19th centuries, the long reach of U.S. law mostly concerned torts and piracy. Starting in the early 20th century, U.S. law gradually began to be applied extraterritorially in the realms of environmental and economic regulation, with the latter including anti-trust, banking, bankruptcy, securities, taxation, and labor. Since the 1970s, the extraterritorial reach of domestic law has increased significantly as U.S. policy-makers

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have pursued a wide range of foreign policy and national security objectives. Encroaching upon the sovereignty of other nations, the assertion of U.S. authority beyond borders has repeatedly sparked intense political conflicts with adversaries and allies alike. An acute contemporary conflict of U.S. and EU law is currently unfolding in the case of Iran.

How U.S. Trumps European Law

On May 8, 2018, President Donald J. Trump fulfilled yet another campaign promise by announcing to cease U.S. participation in the Joint Comprehensive Plan of Action (JCPOA). Under the terms of the executive agreement, which was not ratified by the U.S. Senate but endorsed in Security Council Resolution 2231, the Iranian government agreed to strict limits on — and enhanced monitoring of — its nuclear program in exchange for relief from international sanctions. Criticizing the limited duration and insubstantial scope of the JCPOA, the Trump administration's withdrawal was immediately followed by a "maximum pressure" strategy. Its objective, as laid out by Secretary of State Mike Pompeo in May 2018, is to force the Iranian leadership into accepting a set of 12 far-reaching demands that are geared to fundamentally change not only its nuclear but also regional and domestic policies.

The principle means to pursue these maximalist demands is the use of unilateral U.S. sanctions. On August 6, 2018, President Trump issued Executive Order 13846, which re-instated the so-called nuclear-related, unilateral U.S. sanctions previously lifted under the terms of the JCPOA. The impact of those measures had crippled the Iranian economy between mid-2010 and late 2013. A first wave entered into effect immediately, encompassing a limited set of prohibitions on purchases of U.S. dollar banknotes by the Iranian government; the sale, supply, or transfer of various metals to or from Iran; the purchase or holding of Iranian rials or Iranian sovereign debt; as well as transactions involving the Iranian automotive sector. A second wave entered into effect on November 5, 2018, containing numerous measures collectively aimed at curtailing the Iranian government's revenue from oil exports.

Additionally, the Trump administration had continued to strictly enforce the so-called non-nuclear sanctions until early November 2018. The departments of the Treasury and State blacklisted 168 individuals and entities in 19 rounds for their involvement in the Iranian ballistic missile program and alleged human rights violations against the Iranian people.

Well ahead of the deadlines set by the Trump administration and absent any enforcement action, major European and Asian companies withdrew from the otherwise lucrative Iranian market. Most notably, this included the Society for Worldwide Interbank Financial Telecommunication (SWIFT) — the most widely used messaging system among international financial institutions — which cut off most of the more than 50 Iranian banks in early November 2018, including the Central Bank of Iran, after they again became subject to U.S. financial sanctions.

The withdrawal of EU-based companies from Iran-related business further decreased the incentives for the Iranian leadership to uphold its commitments under the JCPOA, as it contributed to the worsening of economic conditions. Apart from further pushing the JCPOA to the brink of collapse, the exodus of EU-based companies has revealed an inconvenient truth to European policymakers, namely that those companies are effectively regulated in Washington, D.C.

Europeans Exposed As Helpless

In response to President Trump's decision to cease U.S. participation in the JCPOA, European foreign policy-makers publicly vowed to keep the Iranian nuclear deal from falling apart. In order to protect EU-based companies from the looming threat of re-imposed unilateral U.S. sanctions, the governments of France, Germany, and the United Kingdom (E3), together with the European Union (EU), acted on four different fronts. Firstly, the European Council updated Council Regulation (EC) No 2271/96 to include many — but not all — unilateral U.S. sanctions against Iran. This so-called blocking statute prohibits EU-based individuals and companies from complying with six statutes and one set of regulations listed in the annex, while providing a clawback provision to recover incurred damages in European courts. Secondly, the European Council and the European Parliament updated the External Lending Mandate of the European Investment Bank to facilitate loans for private investment in Iran. Thirdly, the European Commission unveiled a set of confidence-building measures, including a €50 million support package for economic cooperation with — and assistance for — the Iranian private sector. Fourthly, the High Representative of the European Union for Foreign Affairs and Security Policy, working jointly with the French and German governments, set up a payment mechanism independent from the U.S. dollar. The Instrument in Support of Trade Exchanges (INSTEX) — registered in France and overseen by three high-ranking bureaucrats from the E3 — is designed to enable the bartering of Iranian commodities, and potentially those from other suppliers, in exchange for European goods, technology, and services without an underlying financial transaction. The Russian and Chinese governments have previously engaged in similar steps. For example, the *China International Payment System* has allowed cross-border and offshore financial transactions denominated in renminbi since October 2015.

However, these steps have fallen short of achieving their intended purpose of protecting EU-based companies from the re-imposed unilateral U.S. sanctions. To start with, Council Regulation (EC) No 2271/96 had previously been ineffective because its comparatively small fines did not outweigh the much greater damage resulting from disobeying unilateral U.S. sanctions. Moreover, the so-called blocking statute was undercut by mixed signals that were mainly sent from the German chancellor, Angela Merkel, who had raised doubts about its effective implementation on the national level. In fact, the language of the statute is ambiguous while also enabling EU-based companies to make their own business decisions to abstain from certain transactions. Those may incidentally happen to be targeted by certain unilateral U.S. sanctions. In any case, favorable judgments secured in European courts would be largely unenforceable in the United States.

Whereas the technical implementation is relatively straightforward, the INSTEX seems hardly connectable to private businesses, the majority of which would remain highly reluctant to engage in potentially illegal — or, at least, sanctionable — activity under U.S. law. This substantial risk extends to small and medium-sized companies willing to continue trade with Iran and without — or very little — exposure to the U.S. market, given that their respective business partners might stop dealing with them. Due to these difficulties of connecting such a special purpose vehicle to the broader European economy, it may only be suited to facilitate trade in agricultural commodities, medicine, and medical goods that is still legal under U.S. law.

Therefore, the currently available policy options at the disposal of European foreign policy-makers fall short of effectively changing the risk calculus of EU-based companies threatened by the extraterritorial reach of U.S. law. As a consequence, the EU/E3 seem unable to safeguard the JCPOA — one of their major foreign policy achievements — from being actively sabotaged by the Trump administration. Whereas previous administrations have backed down out of a concern for not wanting to alienate their European allies, the Trump administration shows no intention of resolving the trans-Atlantic conflict of laws in a similar fashion. This uncompromising stance could intensify, as the administration may soon be mandated by Congress to significantly increase its enforcement of unilateral U.S. sanctions against Russia or China, with potentially devastating effects for European — and particularly German — economic and security interests. As a matter of fact, any potential decrease in European exposure to U.S. goods, technology, and (financial) services will offer little protection against extraterritorial U.S. sanctions, which increasingly target persons, property, and acts without any nexus to U.S. jurisdiction whatsoever.

Statutory Sources

The most important statutory sources prescribing unilateral U.S. sanctions in the realm of foreign policy and national security are the *Trading with the Enemy Act of 1917* (TWEA) during wartime, and the *International Emergency Economic Powers Act of 1977* (IEEPA) during peacetime. Upon a prior declaration of the existence of a national emergency under the *National Emergencies Act of 1976*, the president can invoke the broad powers delegated by Congress under the IEEPA in order to prohibit almost any unlicensed import into, as well as any unlicensed export of goods, technology, and (financial) services from the United States, including re-exports from third countries. Most notably, the IEEPA allows the president to block property, as well as any interest therein, under the jurisdiction of the United States.

Besides the TWEA and the IEEPA, further statutes prescribe unilateral U.S. sanctions. Most importantly, those include the *Atomic Energy Act of 1954* (AEA), the *Arms Export Control Act of 1976* (AECA), and the *Export Controls Act of 2018* (ECA), which provide the president with the authority to prohibit almost any unlicensed export of nuclear equipment and materials (AEA), military items and software (AECA), as well as dual-use goods, technology, and services (ECA), including re-exports from third countries.

All of the aforementioned statutes contain so-called primary sanctions, as they only target persons, property, and acts that are "subject to the jurisdiction of the United States." Although the concrete reach of any of those laws may vary — depending on the specific legal language employed — some similarities do exist. The term "U.S. person" usually encompasses individuals physically present within the United States, as well as U.S. citizens and nationals anywhere in the world. The term "entity" typically includes both non-profit organizations as well as companies organized under U.S. laws, including their foreign branches. And the term "property" commonly applies to any goods, technology, and (financial) services that are exported from the United States or re-exported from third countries.

Since the early 1990s, bipartisan majorities in Congress have begun to enact statutes prescribing so-called secondary sanctions. Despite continuous opposition from the executive branch, a steadily growing number of laws target non-U.S. persons engaged in specific conduct such as investing in specific sectors of the Iranian and Russian economies or transacting with persons blacklisted by the U.S. administration. Technically, there can be no violation of secondary sanctions because the triggering activities are not prohibited under U.S. law but sanctionable. In any case, the president enjoys considerable flexibility in implementing secondary sanctions, as doing so requires a prior determination of non-compliance by non-U.S. persons. Consequently, U.S. persons are prohibited from engaging in certain transactions, which may result in a partial or comprehensive cut-off from the $14 trillion U.S. economy. For example, the secretary of the Treasury can order U.S. banks to close or impose strict conditions on the opening or maintaining of correspondent or payable-through accounts on behalf of a foreign bank, thereby closing down access to dollarized transactions — the "Wall Street equivalent of the death penalty." Furthermore, Congress authorized the Department of the Treasury in 2012 to block property under U.S. jurisdiction of those non-U.S. persons transacting with certain blacklisted Iranian persons.

Extraterritorial Enforcement

Unilateral U.S. sanctions are enforced extraterritorially by various executive agencies. Those include, but are not limited to, the Nuclear Regulatory Commission within the Department of Energy, which administers regulations promulgated under the AEA; the Bureau of Industry and Security within the Department of Commerce, which administers regulations promulgated under the ECA; and the Directorate of Defense Trade Controls within the Department of State, which administers regulations promulgated under the AECA.

The Office of Foreign Assets Control (OFAC) within the Department of the Treasury promulgates regulations under the IEEPA as well as a small number of other statutes. The OFAC also maintains the notorious Specially Designated Nationals (SDN) and Blocked Persons List, currently composed of more than 13,000 individuals and entities. A listing results in the blocking of property, and any interest therein, that is owned or controlled by any one of the entries and falls under U.S. jurisdiction. Moreover, U.S. persons are generally prohibited from transacting with so-called SDNs.

All SDNs were designated under at least one of the more than 30 country-based or issue-specific programs targeting both state and non-state actors. Most of these programs have been initiated by executive orders pursuant to the IEEPA, although some were directly enacted through statutes passed by Congress. The respective reasons for being added to the SDN List can either be status- or conduct-based. The latter includes a variety of alleged actions incriminated under various statutes, such as material support for international terrorism; proliferation of weapons of mass destructions and their means of delivery; human rights abuses; as well as transnational crimes such as narcotics trafficking and malicious cyber-enabled activity.

The regulations promulgated by the OFAC under the IEEPA commonly lack any applicable threshold for establishing liability. Consequently, any export of goods, services, or technology from the United States that has not previously been authorized either through a specific or general license is strictly prohibited, regardless of the quantity. But compared to its wartime predecessors, the OFAC has generally shown forbearance in defining the reach of its enforcement jurisdiction. Hence, most regulations solely apply to U.S. persons, except for the *Cuban Assets Control Regulations* and the *Iran Transaction and Sanctions Regulations*, which apply to “any person subject to the jurisdiction of the United States.” This seemingly small difference carries profound legal implications because it effectively extends U.S. jurisdiction over the large number of independently operating foreign subsidiaries of U.S. parent companies.

In order to enforce the IEEPA, the OFAC can impose civil monetary fines of up to $295,141 per violation, or twice the amount of the incriminated transaction. The exact amount is calculated by weighing various factors laid out in the Economic Sanctions Enforcement Guidelines. This administrative process offers little transparency and is not subject to judicial review under the *Administrative Procedure Act of 1946*. In December 2007, Congress established liability for anyone who causes a U.S. person to violate the IEEPA. This led the OFAC to slap huge civil fines on major foreign banks facilitating financial transactions cleared in dollars on behalf of persons blacklisted by the U.S. administration.

Furthermore, the OFAC can directly monitor compliance with its regulations by delisted non-U.S. persons. Such a case recently involved an agreement between the OFAC and three companies previously controlled and majority-owned by an SDN, the Russian billionaire Oleg Deripaska.
In the future, the OFAC may become more and more adept in targeting prominent individuals who may be important shareholders of major companies without disrupting global value chains.

Finally, the OFAC can refer violations of the IEEPA to the Department of Justice for criminal prosecution. This guarantees more due process protections under the U.S. Constitution. However, a conviction might result in huge monetary penalties as well as imprisonment of up to 30 years. The extraterritorial enforcement is supported by extradition treaties to detain individuals sought by the U.S. Department of Justice in third countries. Recent prominent cases involve the arrest of the Chief Financial Officer of the Chinese telecommunication company Huawei, Meng Wanzhou, who was detained by Canadian authorities in early December based on a warrant issued by the U.S. Attorney in the Eastern District of New York. Another high-profile case revolved around Reza Zarrab, who was arrested during a family trip to Miami, FL, in March 2016. He was charged with six counts — among them conspiracy to evade unilateral U.S. sanctions against Iran — that would have carried a sentence of up to 70 years in prison. By pleading guilty and agreeing to act as a cooperating witness against another defendant in the same case, Zarrab eventually reduced his pending sentence.

No Limits under International Law

The extraterritorial prescription of U.S. law and its extraterritorial enforcement by means of unilateral sanctions occupies a gray area in public international law, which governs interactions between sovereign nation-states either through formal treaties or widely accepted customs.

With regard to conventional international law, the U.S. government enjoys wide latitude to curtail trade and financial transactions. In its numerous bilateral treaties of friendship, commerce, and navigation concluded with other nations, the U.S. government faces no limits on its use of unilateral sanctions due to foreign policy and national security exceptions. This lack of legal barriers to the extraterritorial reach of U.S. law also holds true for multilateral treaties, which commonly contain broad exceptions for matters of national security. Those include Article VIII Section 2(b) of the Articles of Agreement of the *International Monetary Fund* and Article XXI of the World Trade Organization. Contrary to the vocal critics of unilateral U.S. sanctions, there exists no right to economic exchange, according to the landmark ruling *Nicaragua v. United States* by the International Court of Justice dating from June 1986. Up until today, the application of economic power in international relations has so far largely defied attempts at legalization.

With respect to customary international law, the U.S. government is generally permitted to assert prescriptive and enforcement jurisdiction extraterritorially on the basis of the following five principles. Firstly, the *objective territoriality principle* allows the U.S. government to address direct and substantial effects resulting from acts committed beyond U.S. borders. Also known as the "effects doctrine," this principle originated from the century-old *subjective territoriality principle*, which establishes jurisdiction over persons, property, and acts located or conducted within U.S. territory. Secondly, the *active nationality principle* permits the U.S. government to regulate its own citizens and nationals anywhere in the world. Thirdly, the *passive nationality principle* enables the U.S. government to prosecute harm or injuries done to its citizens or nationals abroad. Fourthly, the *protective principle* may establish jurisdiction to counter threats to U.S. national security. Finally, the *universality principle* can be advanced to bring to justice the perpetrators of crimes committed against humanity.

The application of these principles to concrete situations is open to interpretation. Beyond the protective principle, the U.S. administration has extensively stretched two particular principles in order to justify the long reach of its jurisdiction to enforce U.S. law abroad in recent years. Firstly, the OFAC commonly has relied on the active nationality principle in order to claim enforcement jurisdiction over foreign companies that are owned or controlled by a U.S. person more than 50 percent (or, in some instances, even less). This so-called control theory has remained controversial ever since it was initially adopted by the Theodor S. Roosevelt administration in late 1942 in the fight against the Axis powers. Later on, this expansive interpretation of U.S. jurisdiction had been repudiated in the landmark decision *Barcelona Traction*, handed down in February 1970 by the International Court of Justice, which ruled that the place of incorporation would determine the nationality of a company, and not the nationality of its owners or shareholders. This line of reasoning was strongly reaffirmed by the Commission of the European Communities in an *aide-mémoire* sent to the U.S. Department of State in August 1982. The *démarche* was part of the European response to a prior extension of U.S. export controls to extend to subsidiaries of U.S. parent companies incorporated in Europe, and that had been involved in the construction of a gas pipeline between West Germany and the Soviet Union.

Furthermore, the U.S. government regularly stretches the nationality principle by attaching its enforcement jurisdiction not only to goods, technology, and (financial) services after they are exported, but also to any goods, technology, and (financial) services located beyond U.S. borders that contain more than 10 percent of U.S.-origin components. Most importantly, the clearing of dollars between two foreign banks — a ubiquitous practice at the heart of the global economy — is construed by the U.S. administration and some federal courts as constituting an export of services from the United States. This is because it involves a correspondent account held at a U.S. bank.

Secondly, the OFAC and other agencies have stretched the objective territoriality principle, shifting the focus away from the location in which a regulated act occurs to where its effects materialize. Initially recognized by the Permanent Court of International Justice in its landmark *Lotus* case dating from September 1927, it found its way into U.S. jurisprudence through the decision *United States v. Alcoa* by the Court of Appeals for the Second Circuit (148 F.2d 416) in March 1945. In contrast to established practice in the realm of U.S. antitrust statutes, the extraterritorial enforcement of the IEEPA generally lacks any objective criteria as to when certain effects materializing within the United States may be deemed as “direct” and “substantial.” Therefore, interpretations of the objective territoriality principle with respect to U.S. foreign policy and national security policy remain highly subjective.

By simultaneously stretching the nationality and objective territoriality principle and undermining the subjective territoriality principle, the U.S. government further contributes to sidelining the century-old principle of comity, which counsels restraint in the case of concurrent jurisdiction by more than one state. Without comity, however, President Trump’s favored reassertion of the nation-state within the international order is bound to perpetuate legal conflicts.

Curbs through Domestic Courts

Contrary to Article 25 of the German *Grundgesetz*, which incorporates international law into domestic law, the U.S. Constitution spells out no limits for Congress to extend its laws extraterritorially. But most U.S. statutes and their implementing regulations remain silent on their geographical scope, including the IEEPA. The precise reach of U.S. statutes beyond borders must consequently be discerned by the judiciary.

Indeed, many federal district courts have supported the U.S. administration’s expansive interpretation of its enforcement jurisdiction while not even considering possible limits to the extraterritorial reach of the IEEPA. Thus, the district courts did not engage in weighing the respective interests of the United States and those of the other nations involved in each respective case. Most foreign defendants charged with violating U.S. law abroad have generally preferred to forego criminal proceedings in exchange for entering into Deferred Prosecution Agreements, in which they submit to civil enforcement by the U.S. administration. Up until now, the extraterritorial application of the IEEPA has rarely been litigated in federal district and appellate courts, let alone in the Supreme Court.

Despite this reluctance, which is understandable given the high reputational and business risks involved, the prospects for successfully challenging the U.S. administration's expansive interpretation of its enforcement jurisdiction in domestic courts may have grown recently. This is due to a strengthening of a set of rules developed by the Supreme Court to interpret the reach of extraterritorial U.S. jurisdiction, which is binding for the lower courts. Known as the "presumption against extraterritoriality," it holds that U.S. law would primarily apply domestically unless Congress has explicitly determined otherwise. This set of rules complements an earlier set of rules known as the *"Charming Betsy"* presumption, which dates back to the early 19th century. Accordingly, the intent of Congress could only be interpreted to violate international law if no other construction is possible.

Taken together, these two so-called canons of statutory construction could provide leverage for defendants charged with having violated U.S. law abroad, arguing that U.S. jurisdiction may not be applied to them or their conduct. Additional leverage may soon be provided, given the unobstructed nominations of conservative judges to the federal bench by a solid Republican majority in the U.S. Senate. Most of the candidates nominated by President Trump share a particular judicial philosophy that espouses a textual reading of the U.S. Constitution and is deeply skeptical about the growth of executive power and the expansion of the administrative state during the last 60 years. A sign in this direction: The Supreme Court has recently agreed to hear a case that might revoke — or at least circumscribe — the so-called Auer deference. This precedent was initially set in the decision *Auer v. Robbins* dating from 1997, which has allowed executive agencies to interpret ambiguous regulations on their own ever since. A conservative majority on the Supreme Court may even go a step further and reconsider the precedent set in *Chevron U.S.A. v. Natural Resources Defense Council*. The 1984 decision has allowed executive agencies to interpret the meaning of statutes that authorize their actions.

As a complement to the rather helpless efforts at increasing their strategic autonomy vis-à-vis the U.S. government, European foreign policy-makers could better utilize existing channels of influence by relying upon the U.S. judiciary within the constitutional system of check and balances. In practice, this means systematically encouraging and eventually assisting EU-based companies in domestic courts to challenge the U.S. administration's extraterritorial enforcement of the IEEPA, and potentially also other statutes. Such a course of action would require close cooperation between the European Commission, individual member states, and the private sector on both sides of the Atlantic. But absent a diplomatic agreement with the U.S. administration or significant pushback from Congress, it may provide the only remedy to effectively protect European sovereignty through the normative power of the rule of law.

Dr Sascha Lohmann is an Associate in the Americas Division.

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SWP
Stiftung Wissenschaft und Politik
German Institute for International and Security Affairs

Ludwigkirchplatz 3 — 4
10719 Berlin
Telephone +49 30 880 07-0
Fax +49 30 880 07-100
www.swp-berlin.org
swp@swp-berlin.org

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