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## Congress Turns to Capital Markets to Support Sanctions

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**For years the US has imposed economic sanctions on certain nations it deems undesirable. Now the Bush administration is facing potential conflicts of interest as Congress pursues an aggressive policy, making use for the first time of the US capital markets. Danforth Newcomb and Saamir Elshihabi of Shearman & Sterling's New York office, and Perry Bechky in Washington, DC, discuss the compliance issues companies need to understand about the proposed legislation**

# Congress turns to capital markets to support sanctions

**E**arly predictions about the Bush administration's approach to economic sanctions policy overestimated the new administration's flexibility in this area. With President Bush's and Vice-President Cheney's backgrounds in the oil industry, some felt the new administration would push to ease sanctions against Iran and Libya. Conversely, with Cuban Americans in Florida having provided Bush's margin of victory over Al Gore, some saw the new administration strengthening the embargo against Cuba. In fact, developments this summer have shown that the administration will balance competing considerations, including Congressional fondness for some sanctions and EU opposition to "extraterritorial" sanctions, to make policy choices that have so far managed to avoid out-and-out confrontation with either camp – even when this approach has involved continuing Clinton administration policies previously criticized by Republicans.

## Congressional proponents of sanctions have opened a significant new front in the political battles over extraterritorial sanctions: the US capital markets

At the same time, Congressional proponents of sanctions have opened a significant new front in the political battles over extraterritorial sanctions: the US capital markets. Under Congressional pressure, the acting chairman of the Securities and Exchange Commission (SEC) has started to require foreign issuers to disclose information about their business activities in countries subject to US sanctions. Even though the administration's nominee for the SEC's chairmanship has voiced doubts about the appropriateness of requiring such disclosures, Congress is threatening to go further. The House of Representatives recently passed a bill that would, if enacted, bar companies that do oil-related business in Sudan from raising capital in the US. These developments will surely test the

administration's ability to continue avoiding confrontations over sanctions policy.

### Increasing congressional influence

The US Constitution has famously been described as inviting the president and Congress to struggle over the control of foreign affairs, but historically there has been little struggle over economic sanctions policy. Congressional activity in this area was basically limited to passing two statutes, the Trading with the Enemy Act (TWEA) of 1917 and the International Emergency Economic Powers Act (IEEPA) of 1977, that gave the president wide discretion to determine whether and how to impose sanctions.

More recently, however, tensions began to develop between Congress and the executive branch with respect to sanctions policy, and a movement emerged to reduce the president's flexibility. Congress started asserting its powers, including its power to pass legislation governing "foreign commerce", to influence specific sanctions policies targeted at individual countries or concerns. Beginning with Congressional efforts in the 1980s to force the Reagan administration to impose "comprehensive" sanctions against South Africa and a variety of more "targeted" sanctions against countries engaged in environmental, human rights, weapons proliferation and other practices opposed by the US, the trend appeared to have peaked in 1996, with the passage of the Helms-Burton Act on Cuba and the Iran and Libya Sanctions Act (ILSA). Both statutes were attempts by Congressional proponents of sanctions to limit presidential discretion and bring about "tougher", "mandatory", "extraterritorial" sanctions policies.

This movement, of course, gave rise to a counter-movement. Business groups formed the "USA Engage" coalition favouring "engagement" over sanctions. Cheney, then the CEO of Halliburton, gave speeches criticizing over-reliance on sanctions. The EU started a World Trade Organization (WTO) case challenging Helms-Burton and ILSA. The Clinton administration struck compromises with the EU, forestalling the WTO case and effectively minimizing the practical significance of Helms-Burton and ILSA for several years. Farming interests

obtained legislation largely exempting exports of food and medicine from embargoes. A “sanctions reform” bill even gained some momentum among pro-business congressmen.

Recent developments, however, have shown the counter-movement’s limits. Congressional influence over day-to-day sanctions policy is alive and well. Congress has the power, not only to limit presidential initiatives in sanctions policies, but also to put new sanctions initiatives on the policy agenda. For the foreseeable future, the Bush administration will need to intimately engage Congress when calibrating sanctions policies. In turn, this will require careful balancing of domestic political constituencies and adroit management of recurring tensions with the EU and other friendly governments. In that regard, the next two major challenges can be seen on the horizon: a possible resumption of the dispute over the executive travel sanctions in Title IV of Helms-Burton; and a potentially major new dispute in an arena previously unexposed to sanctions debates: access to the US capital markets.

### Iran and Libya Sanctions Act

ILSA was enacted originally in 1996 with specific extraterritorial intent. In 1995, when the Clinton administration forced a US oil company to back out of an oil exploration project in Iran, a French oil company took its place. ILSA reflected a Congressional effort to present foreign oil companies with a simple choice: do business with Iran or Libya, or do business with the US. The legislation therefore created “triggers” that mandated presidential investigation of companies investing in the energy sector in Iran or Libya or selling specified goods to Libya. If a violation is determined, the president must impose two or more of certain enumerated sanctions (including caps on access to US credit and loan facilities), unless he certifies to Congress that a waiver is “important to the national interest of the United States”

In 1998, the Clinton administration invoked that waiver language as the basis for reaching an understanding with the EU that effectively froze enforcement of ILSA against European companies, in return for the Europeans’ cooperation in controlling the flow of weapons of mass destruction to Iran and Libya. Individual transactions were investigated, but sanctions were never invoked. The Bush administration seemed content to continue this policy, ILSA was scheduled to expire in August 2001, and that might have been the end of this chapter in sanctions policy.

But Congress wanted to renew ILSA for another five years. The Bush administration did not vigorously oppose the Congressional initiative. The administration proposed limiting the extension to two years, but Congress insisted on five years. The administration also suggested a procedural mechanism that might have led to termination in less than five years, but that too failed to make it into the final version of the ILSA Extension Act of 2001, which President Bush signed into law on August 3.

Moreover, in two respects, the Extension Act actually expanded ILSA. First, the Extension Act lowered the threshold for the Libyan investment “trigger” from \$40 million to \$20 million – the same threshold that applies to Iran – for investments made after June 13 2001. Second, the Act brought within ILSA’s reach all pre-existing contracts, even contracts that were in effect before 1996, if they are amended in any way after June 13 2001.

The strong Congressional support for ILSA evidenced in the Extension Act may also have implications for the administration’s enforcement policy. The administration’s willingness to waive sanctions will be tested against Congressional pressure to more rigorously enforce the law, and the result will be influenced over time by domestic and global political events. Therefore, companies should actively monitor the latest political developments to assess their potential ILSA risk.

### Helms-Burton Act

The Helms-Burton Act, which also passed in 1996, made three key changes in the US embargo against Cuba. First, it “codified” the embargo. The embargo had existed for decades under executive branch regulations, and it had been strengthened or weakened as successive administrations tailored it to the circumstances of the day, but the Helms-Burton Act declared that the regulations would be treated as a statute. While this “codification” raises many legal questions, its political implications are clear: no major changes may be made in Cuba policy without Congressional approval. As a result, there has been markedly more Congressional involvement in the details of policy regarding Cuba than with other targets of US sanctions.

Second, Title III of the Act invented a creative new type of sanction: US lawsuits. Specifically, Title III allows US claim-holders to sue persons who “traffic” in Cuban property that had been expropriated by the Cuban government any time since January 1 1959 for three times the present-day value of the property. “Trafficking” is defined broadly and includes use or possession of property acquired before enactment of the Helms-Burton Act. The definition also includes a company that “causes, directs, participates in, or profits from trafficking” by another company, which may be construed to apply to corporate parents or even other corporate affiliates of companies doing business in Cuba.

### Congressional influence over day-to-day sanctions policy is alive and well. Congress has the power, not only to limit presidential initiatives in sanctions policies, but also to put new sanctions initiatives on the policy agenda

The president may waive Title III, provided that he certifies every six months that such a waiver is “necessary to the national interests of the United States and will expedite a transition to democracy in Cuba” Pursuant to an agreement with the EU, President Clinton waived the right to bring lawsuits under Title III every six months from July 1996 through January 2001. This policy was vigorously criticized by Senator Helms and other Republicans, and by Cuban-American proponents of the legislation. It was therefore uncertain whether Bush would continue Clinton’s waiver policy. On July 16, Bush announced a waiver for the next six months, through January 2002. Helms and other sanctions proponents downplayed their criticisms of this waiver – perhaps because Bush is still enjoying a honeymoon period with Congressional Republicans.

Or, perhaps, the proponents of Helms-Burton are “holding their fire” while waiting to see how the new administration will handle the third key aspect of the act. Title IV requires the president to bar from entering the US the executives of companies found to be “trafficking” – and their families as well. Title IV cannot be waived. Under the agreement with the EU, Clinton proposed that Congress add a waiver authority to Title IV, but Congress has not done so. Absent waiver authority, the Clinton administration seems to have adopted a policy that potential Title IV violations were to be studied very rigorously before making any conclusions. As a result, after an initial group of three companies were sanctioned under Title IV, no others followed. Helms used his leverage over nominees to the Bush State Department to press for commitments for prompt decisions under Title IV, focusing particularly on a long-

### **ILSA reflected a Congressional effort to present foreign oil companies with a simple choice: do business with Iran or Libya, or do business with the US**

studied investment in Cuba by a Spanish hotel chain. The EU has threatened to resume its WTO case if any European companies are sanctioned under Title IV. Unless the administration can secure the authority to waive Title IV, this will remain one of the riskiest flash-points in sanctions policy.

#### **SEC sanctions disclosure**

Congress need not act formally to exert influence over sanctions policies. Even a simple letter from a single congressman can prompt a policy shift. This power was illustrated in May 2001, when the acting chairman of the SEC responded to a letter from Representative Frank Wolf. Wolf objected to the fact that some foreign issuers are raising capital in the US when they are also doing business in countries subject to US embargoes. In response, the acting chairman stated that the SEC did not have the authority to bar such companies from issuing securities in the US. Agreeing with Wolf that such activities would be “significant to a reasonable investor’s decision about whether to invest in that [foreign] company”, the acting chairman also announced new initiatives to require “enhanced disclosures” by foreign issuers of their business activities and relationships with governments, entities and individuals subject to US economic sanctions administered by the Treasury Department’s Office of Foreign Assets Control (OFAC). Specifically, the SEC will review filings by foreign issuers to obtain information about:

- their material business in countries subject to OFAC sanctions;
- their business relationships with such countries, or with individuals or entities on OFAC’s so-called “specially designated nationals” list; and
- situations in which the proceeds of an offering could benefit, however indirectly, such countries, individuals, or entities.

Finally, to facilitate enforcement actions, the SEC also announced that it will increase its cooperation with OFAC on sanctions-related matters.

Although the SEC has already started to require “enhanced disclosures” from foreign issuers, it seems that this new policy is

not supported by the Chairman-designate, who has questioned whether such information is “material” to investors as that term has traditionally been construed under the securities law. The ultimate outcome will likely depend on how much Wolf and Congress push for, and on how much the SEC and the Bush administration resist, this new disclosure policy.

#### **Sudan Peace Act**

On June 13 2001, the US House of Representatives voted to take the capital markets issue two steps further by passing the Sudan Peace Act. First, if enacted, this bill would essentially “codify” the SEC’s letter to Wolf, by requiring any foreign issuer doing any business in Sudan to disclose extensive information about the nature and extent of such business, including any plans for expansion or diversification, the identity of all agencies of the Sudanese government with which the entity is doing business, and the relationship of its activities to any violations of religious freedom and other human rights. Second, and more significantly, this bill also would outright prohibit foreign companies participating in Sudan’s oil and gas industries from raising capital in the US or from trading their securities on any securities exchanges in the US.

On July 19 the US Senate passed its own version of the Sudan Peace Act, which did not include the securities provisions. Now, each house of Congress is considering the other’s version. The Bush administration and Alan Greenspan have publicly objected to the securities-related provisions in the House version. Nonetheless, depending on the negotiations between the Senate and House, some version of the securities provisions could be included in the final legislation presented to the president. Once again, the outcome will likely depend on how hard Congressional proponents push for, and how hard the administration opposes, the proposed sanctions.

#### **Other sanctions affecting capital markets**

Finally, the trend among some members of Congress towards utilizing the capital markets as a means to achieve foreign policy goals is also illustrated by two other developments. First, on August 2, Helms introduced in the Senate a new bill that would, if enacted, bar access to US capital markets by enterprises owned or controlled by the People’s Republic of China (PRC). Known as the China Free Enterprise Act of 2001, this legislation is still early in its development. Second, during consideration of the ILSA Extension Act, a congressman advocated possible legislation, like the securities restrictions in the House version of the Sudan Peace Act, directed against companies participating in Iran’s oil industry. To date, no such legislation has been introduced.

#### **Conclusion**

At the moment, the Bush administration’s overall policy on sanctions looks very similar to the sanctions policy followed by President Clinton late in his administration. Congressional activity in this area, however, will continue to pose future challenges for President Bush as he tries to balance Congress’s aggressive stance on sanctions with competing political pressures from business concerns and foreign allies. The most contentious issues in the near future could arise from Congressional efforts to find new jurisdictional bases to apply US sanctions laws to foreign companies, whether by denying the companies themselves access to US capital or by denying their executives (and their families) access to US territory. ■