



Working Paper

**WTO Compatibility of United States'
Secondary Sanctions Relating to
Petroleum Transactions with Iran**

Shailja Singh

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TRANSACTIONS WITH IRAN**

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I. INTRODUCTION

The United States has done it again. Undeterred by the controversy that surrounded one of its previous attempts¹ to impose *secondary sanctions*,² the United States has incorporated secondary sanction provisions in its National Defense Authorization Act for Fiscal Year 2012 (“NDAA”). Section 1245 of the NDAA, *inter alia*, authorizes the United States President to impose sanctions on foreign financial institutions owned or controlled by the government of a foreign country, including a central bank of a foreign country, that facilitates or conducts a financial transaction for the purchase of petroleum or petroleum products from Iran after the June 28, 2012³ deadline set by it.⁴ In other words, foreign financial institutions will be completely cut-off from the United States' banking system if they facilitate or conduct purchase of petroleum or related products from Iran after the said deadline.

The distinguishing feature of sanctions under Section 1245 is that the primary target of the sanction is Iran and not the country to which the foreign financial institutions belong to, hence in respect of the latter - the sanctions are secondary in nature. Such a unilateral action on part of the United States

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¹ See Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1996 (the Helms-Burton Act), 22 U.S.C.A §§ 6021-6091 (West Supp. 1997) and numerous discussions relating to its consistency within the multilateral framework: Walker, Joseph, *The Legality of the Secondary Boycotts contained in the Helms –Burton Act under International Law*, 3 DePaul Dig. Int'l L. 1; Bhala, Raj, *Fighting Bad Guys with International Trade Law*, 31 U.C. Davis L. Rev. 1; Taylor, C. O 'Neal, *Impossible Cases: Lessons from the First Decade of the WTO Dispute Settlement*, 28 U. Pa. J. Int'l Econ. L. 309; Spanogle, John, *Can the Helms-Burton Be challenged under the WTO?*, 1998 Stetson Law Review 1313 (Vol. XXVII); Trachtman, Joel, *Regulatory Jurisdiction and the WTO*, 10 J. Int'l Econ. L. 631; Ryngaert, Cedric, *Extraterritorial Export Controls (Secondary Boycotts)*, 7 Chinese J. Int'l L. 625.

² See Meyer, Jeffrey, *Second Thoughts on Secondary Sanctions*, 30 U. Pa. J. Int'l L. 905 at 926. [Secondary sanctions...mean any form of economic restriction imposed by a sanctioning or sending state that it intended to deter a third party or its citizens and companies from transacting with a sanction target. One form of secondary sanctions is secondary boycott]; See Bhala, Raj, *Fighting Bad Guys with International Trade Law*, 31 U.C. Davis L. Rev. 1 [Secondary boycotts should be distinguished from primary boycotts. The essential nature of a primary boycott is that it is an act of self restraint by the boycotting country and concerns only the boycotting country and the target country. A secondary boycott involves not only the boycotting and target countries, but also third-party countries. A secondary boycott attempts to limit the extent of economic dealing of third party countries with the target country.]

³ The sanctions in relation to petroleum transaction take effect from 180 days after enactment of NDAA. June 28, 2012 deadline calculated on this basis.

⁴ The full text of NDAA is available at <http://www.gpo.gov/fdsys/pkg/BILLS-112hr1540enr/pdf/BILLS-112hr1540enr.pdf> (last visited on June 27, 2012).

raises important issues from the perspective of international law, international relations and politics. This presents a good occasion to examine the action of the United States against the backdrop of its obligations under the World Trade Organization (WTO), evaluate the possible defenses available to the United States, and in particular re-open the debate on jurisdiction of a WTO panel when examining a national security defense under General Agreement on Tariffs and Trade, 1994 (GATT, 1994) and General Agreement on Trade in Services (GATS).

The United States has maintained a string of economic and political sanctions against Iran since 1979, and these sanctions have increased in number as well as scope over time, owing to the growing concerns about Iran's nuclear program.⁵ However, it is only recently that the United States has started to target foreign financial institutions dealing with Iran. One such attempt was the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA), through which foreign financial institutions facilitating Iran's proliferation of Weapons of Mass Destruction (WMD) and providing support to terrorist organizations were subject to United States sanctions.⁶ Although CISADA also imposed sanctions in connection with the *energy sector* of Iran, by extending the scope of the existing Iran Sanctions Act, 1996, such sanctions related to development of petroleum resources of Iran, production of refined petroleum products in Iran and exportation of refined petroleum products to Iran.⁷ With the NDAA, the United States has now extended the scope of its economic sanctions to include foreign financial institutions dealing in *petroleum and petroleum product purchases* in Iran as well.⁸ Thus, in effect, the United States is forcing the countries importing petroleum or petroleum products from Iran to look for other sources, if these countries wish to remain connected with the United States banking system, raising questions about the compatibility of the United States sanctions with the WTO.

Similar questions had arisen after the United States' enactment of the Helms-Burton Act in 1996 as well. The Helms-Burton Act was seen as a unilateral attempt by the United States to force countries to participate in its embargo against Cuba.⁹ Through the Helms-Burton Act, the United States had, *inter*

⁵ See Bruno and Johnson, *The Lengthening List of Iran Sanctions* (April 30, 2012), Council on Foreign Relations, available at <http://www.cfr.org/iran/lengthening-list-iran-sanctions/p20258> (last visited on June 27, 2012). Some of the important instruments imposing sanctions on Iran are the *Iran-Iraq Arms Nonproliferation Act, 1992*, the *Iran-Syria-North Korea Non-Proliferation Act* and *Executive Order 13382, 2005*, the *Iran and Libya Sanctions Act of 1996* and the *Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010*.

⁶ See *The Financial Provisions of 'CISADA': The New Iran Sanctions administered by the US Treasury Department*, available at http://www.treasury.gov/resource-center/sanctions/Programs/Documents/CISADA_english.pdf (last visited on June 27, 2012).

⁷ See 22 U.S.C. §§ 8501–8551. See also *Fact Sheet: Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA)*, Bureau of Economic, Energy and Business Affairs, US Department of State, available at <http://www.state.gov/e/eb/esc/iransanctions/docs/160710.htm> (last visited on June 27, 2012).

⁸ See Sec 1245(d)(4), NDAA (22 USC Sec. 8513a(d)(4)).

⁹ See Taylor, C. O 'Neal, *Impossible Cases: Lessons from the First Decade of the WTO Dispute Settlement*, 28 U. Pa. J. Int'l Econ. L. 309, 377; Spanogle, John, *Can the Helms-Burton Be challenged under the WTO?*, 1998 Stetson Law Review 1313 (Vol. XXVII).

alia, threatened to withdraw aid or impose measures which would have led to the refusal of visas and the exclusion of non-US nationals from US territory with respect to those countries that continued to export to Cuba or continued to trade in Cuban origin goods.¹⁰ One of the prevailing views then was that the United States Government "had to be" violating some international obligation by enacting such a law, and "there outta be a law" which prevented what the United States was proposing to do.¹¹ According to the European Communities (EC) the relevant legal framework was provided by the WTO and it approached the WTO for establishment of a panel, after an unsuccessful round of consultations with the US.¹² The EC alleged the United States to be violating its obligations under GATT, 1994 and GATS.¹³ The United States however maintained that this was fundamentally not a trade issue and thus a trade panel could not be requested to decide on this matter since the WTO had no competence to proceed on an issue of American national security.¹⁴ Although a panel was established to deal with the dispute, the United States and EC reached an understanding and the claims of the parties were never evaluated by a WTO panel.¹⁵ Thus, it still remains to be seen whether the panel would entertain the 'lack of competency' argument that the United States had proposed in relation to measures relating to national security.

In the present instance too, with the United States as well as most of the major oil importers from Iran being members of the WTO,¹⁶ the conformity of the United States secondary sanctions with the WTO framework is an important issue that needs to be addressed. This paper will thus focus on the compatibility of Section 1245 of NDAA with the obligations of the United States under the WTO, in general, and the GATT and GATS in particular. Part II of this paper will discuss in detail Section 1245 of NDAA and other relevant legal instruments through which the United States proposes to impose secondary sanctions on petroleum or petroleum product transactions with Iran. Thereafter, this part will try and evaluate whether the imposition of secondary sanctions in the present context presents a valid cause for complaint before the WTO. Part III will look into the defenses available to

¹⁰See LIBERTAD Act of 1996, *supra* note 1.

¹¹ Spanogle, John, *supra* note 1, at 1313-1314.

¹² See *Request for Consultations by the European Communities, United States-The Cuban Liberty and Democratic Solidarity Act*, WT/DS38/1, dated May 13, 1996.

¹³ *Ibid.*

¹⁴ See Dispute Settlement Body, *Minutes of Meeting Held on November 20, 1996*, WT/DSB/M/26, dated January 15, 1997; Dispute Settlement Body, *Minutes of Meeting Held on October 16, 1996*, WT/DSB/M/24, dated November 26, 1996. See also, Sanger David, *US won't offer Trade Testimony on Cuba Embargo*, February 21, 1997, The New York Times, available at <http://www.nytimes.com/1997/02/21/world/us-won-t-offer-trade-testimony-on-cuba-embargo.html?pagewanted=all&src=pm> (last visited on June 28, 2012).

¹⁵ See *European Union- United States Memorandum of Understanding Concerning the US Helms-burton Act and US Iran and Libya Sanctions Act*, April 11, 1997, 36 I.L.M. 529 (1997). See also Note by Secretariat, *United States – The Cuban Liberty and Democratic Solidarity Act, Lapse of the Authority for the Establishment of the Panel*, WT/DS38/6, April 24, 1998.

¹⁶ For the period 1997-2010, France, Japan, Italy, China, India, Indonesia were some of the major importers of petroleum from Iran (Source: WITS Database). See also *Reuters- Fact Box- Iran's crude export and fuel import customers- April 13, 2010*, available at <http://www.reuters.com/article/2010/04/13/iran-factbox-idUSLDE63A01120100413> (last visited on June 27, 2012).

the United States and will closely evaluate if the United States' claim during the Helms Burton controversy relating to the incompetency of the WTO to proceed on issues of national security has any merit. Finally, part IV will highlight the key findings of this paper along with the conclusion.

II. CAN THE UNITED STATES' SECONDARY SANCTIONS BE CHALLENGED BEFORE THE WTO?

Section 1245 of the NDAA relates to imposition of secondary sanctions with respect to the financial sector of Iran. It identifies the Iranian financial sector as a primary money laundering concern¹⁷ and reiterates that the entire Iranian banking sector, including the Central Bank of Iran poses terrorist financing, proliferation financing and money laundering risks for the global financial system.¹⁸ The section envisages imposition of sanctions on a *foreign financial institution*¹⁹ in the following two instances:

- a. The foreign financial institution has *knowingly* conducted or facilitated any *significant financial transaction*²⁰ with the Central Bank of Iran or another Iranian financial institution designated by the United States Secretary of the Treasury for the imposition of sanction; except where such transactions relate to a transaction for the sale of food, medicine, or medical devices to Iran.²¹
- b. The foreign financial institution has conducted or facilitated, 180 days after the date of the enactment of NDAA, the purchase of *petroleum or petroleum products*²² from Iran, if the President of the United States determines that there is a sufficient supply of petroleum and

¹⁷ See Section 1245(b) NDAA (22 USC Sec. 8513a(b)).

¹⁸ See Section 1245 (a)(3) NDAA (22 USC Sec. 8513a(b)).

¹⁹ *Foreign financial institution* can be understood in the light of Iranian Financial Sanction Regulations (IFSR) where it means "any foreign entity that is engaged in the business of accepting deposits, making, granting, transferring, holding, or brokering loans or credits, or purchasing or selling foreign exchange, securities, commodity futures or options, or procuring purchasers and sellers thereof, as principal or agent. It includes but is not limited to depository institutions, banks, savings banks, money service businesses, trust companies, securities brokers and dealers, commodity futures and options brokers and dealers, forward contract and foreign exchange merchants, securities and commodities exchanges, clearing corporations, investment companies, employee benefit plans, and holding companies, affiliates, or subsidiaries of any of the foregoing."; See *Questions Related to the NDAA (Section 1245 of the National Defense Authorization Act for Fiscal year 2012)*, US Department of the Treasury, February 14, 2012, available at <http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx#169> (last visited on June 28, 2012).

²⁰ See Question 174, supra note 19.

²¹ See Section 1245(d)(2) NDAA (22 USC Sec. 8513a(d)(2)). While most of the analysis in the paper will apply in case of secondary sanctions permitted under Section 1245(d)(2) as well, this paper will not engage in a separate analysis of this provision and focus primarily on the secondary sanctions relating to petroleum and petroleum product purchases only.

²² As defined by the U.S. Energy Information Administration (EIA), *petroleum products* include unfinished oils, liquefied petroleum gases, pentanes plus, aviation gasoline, motor gasoline, naphtha-type jet fuel, kerosene-type jet fuel, kerosene, distillate fuel oil, residual fuel oil, petrochemical feedstocks, special naphthas, lubricants, waxes, petroleum coke, asphalt, road oil, still gas, and miscellaneous products obtained from the processing of crude oil (including lease condensate), natural gas, and other hydrocarbon compounds. In keeping with the EIA's standard definition, petroleum products do not include natural gas, liquefied natural gas, biofuels, methanol, and other non-petroleum fuels; See Question 175, supra note 19.

petroleum products from the countries other than Iran to permit a significant reduction in the volume of petroleum and petroleum products purchased from Iran by or through foreign financial institutions.²³

In case a foreign financial institution falls within any one of the above two categories, such foreign financial institution shall be prohibited from opening, and prohibited from or face strict conditions on maintaining, a *correspondent account*²⁴ or *payable-through account*²⁵ in the United States. These foreign financial institutions can be exempted from the sanctions, if the country with primary jurisdiction over the foreign financial institution has significantly reduced its volume of crude oil purchases from Iran.²⁶ As of July 05, 2012, some of the major countries that have been granted exemption from the sanctions include Japan, ten members of the European Union, India, South Korea, Turkey, Malaysia, China and Singapore.²⁷

The impact of the United States sanctions will however not just be limited to the foreign financial institution which is the subject of such a sanction but will adversely impact the trade of the country which has a primary jurisdiction over such a foreign financial institution. One of the basic premises underlying international financial transactions is that any payment made in a particular currency has to be settled through the banking channels of the country to which the currency belongs.²⁸ Thus, if a country 'x' wants to make any payment in US Dollars (USD), it will have to do the same through its financial institutions connected to the banking channels in the United States. Currently, over 35% of international transactions are in dollars, and many of them do not involve American firms.²⁹ However, if these foreign financial institutions are restricted from opening a correspondent account or a payable-through account in the United States, settlement of payment in USD will not be possible. Such foreign financial institutions will be unable to offer dollar accounts and dollar payments, since these rely on links to correspondent American banks.³⁰ The United States sanctions have much wider implication than the text of Section 1245 of NDAA may indicate. In effect, for a country which uses the potential sanction-hit foreign financial institution to make payments related to trade, no trade or minimal trade in goods or services will take place in all cases where the currency of payment for such

²³ Section 1245(d)(4)(C) NDAA (22 USC Sec. 8513a(d)(4)(C)).

²⁴ The term 'correspondent account' means an account established to receive deposits from, make payments on behalf of a foreign financial institutions, or handle other financial transactions related to such institution. See Section 1245(h) NDAA and 31 USC 5318A (e)(1)(B).

²⁵ The term "payable-through account" means an account, including a transaction account (as defined in section 19(b)(1)(C) of the Federal Reserve Act), 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 subaccount, in banking activities usual in connection with the business of banking in the United States. See Section 1245(h) NDAA (22 USC Sec. 8513a), and 31 USC 5318A (e)(1)(C)) .

²⁶ Section 1245(d)(4)(D) NDAA (22 USC Sec. 8513a(d)(4)(D)).

²⁷ See <http://www.bloomberg.com/news/2012-06-28/u-s-exempts-china-singapore-from-its-iran-oil-sanctions.html> (last visited on July 05, 2012).

²⁸ See generally, *Dollar Power*, The Economist, June 23 – 29, 2012, 72.

²⁹ Supra note 30 at 72.

³⁰ Supra note 30 at 72.

trade in goods or services is USD, thus adversely affecting the trade with the United States, once the sanctions come into effect.

On the basis of the above, it appears that the sanctions proposed under Section 1245(d) of the NDAA violate Articles I (*Most-Favored-Nation Treatment (MFN)*), XI (*General Elimination of Quantitative Restrictions*), GATT 1994 with respect to trade in all goods which cannot take place due to the curb on the foreign financial institutions. Furthermore, there also appears to be a violation of Articles II (*MFN*) and XVI (*Market Access*), General Agreement on Trade in Services (GATS), with respect to those services in relation to which the United States has made specific commitments under GATS and trade in which cannot take place due to the secondary sanctions. These are briefly discussed below:

- a. Article I, GATT 1994: Article I, considered one of the pillars of the WTO trading system,³¹ provides *inter alia*, that with respect to all rules and formalities in connection with importation and exportation, any advantage etc granted by a member to any product originating in any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other countries.³² Thus the principal purpose of the MFN provision is to ensure *equality of opportunity* to import from, or to export to, all WTO members.³³ It is this equality of opportunity that will get adversely affected due to sanctions under Section 1245 of NDAA. Maintenance of relevant accounts by foreign financial institutions in the United States is one of the pre-requisites of doing any trade in the United States where the payment has to be made in USD, and this can be considered as a rule or formality in connection with importation and exportation. Article I:1 is very wide in its language and talks of '*all*' rules and formalities in connection with importation and exportation.³⁴ Since, no import/export is possible without requisite payments made in the relevant currency, any restriction that hits this very payment, can be said to fall within the broader category of 'rules and formalities'. Thus, if the United States chooses to impose sanction against select countries and not all, it will be in violation of its obligations under Article I, GATT 1994.

³¹ Appellate Body Report, *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries*, adopted on April 7, 2004, WT/DS246/AB/R, Para 101.

³² Article I:1, GATT 1994.

³³ See Bossche, Van Den, *The Law and Policy of the World Trade Organization: Text, Cases and Materials*, 2008, 324.

³⁴ The phrase 'rules and formalities' have been interpreted widely in the past well. In the Panel Report on *United States - Denial of Most-favoured-nation Treatment as to Nonrubber Footwear from Brazil*, adopted on June 19, 1992, BISD 39S/128, 150, para. 6.8, 'rules and formalities' were held to include the rules relating to revocation of countervailing duties. Similarly, in Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas (Complaint by Guatemala and Honduras)*, WT/DS27/R/GTM, WT/DS27/R/HND, adopted on 25 September 1997, as modified by the Appellate Body Report, WT/DS27/AB/R - 'rules and formalities' have been found to include rules related to tariff quota allocations as well (para 7.107).

- b. Article XI, GATT 1994: Article XI provides for a general prohibition on quantitative restrictions and forms one of the cornerstones of GATT system.³⁵ The language of the Article is comprehensive and applies to all measures instituted or maintained by a contracting party prohibiting or restricting the importation, exportation or sale for export of products other than measures that are in the form of duties, taxes or other charges.³⁶ Furthermore, the panels have also held that Article XI is not just restricted to border measures³⁷ and can extend to restrictions of a *de facto* nature as well.³⁸ In the present instance, sanctions under Section 1245 of NDAA has the effect of imposing a prohibition on the imports or exports into the United States of goods from the countries, whose foreign financial institutions are targeted, and where the currency of transaction is USD. Thus this is a case of *de facto* import prohibition by the United States and hence is in violation of Article XI:1 of GATT 1994.
- c. Article II, GATS: This is the MFN provision under GATS and prohibits discrimination between like services and service suppliers from different countries. Similar to the analysis under Article I, GATT, imposition of sanctions under Section 1245 of NDAA will violate Article II of GATS, to the extent it prevents payment in relation to trade in services, and in effect, resultant trade with respect to some countries and not all.
- d. Article XVI GATS: Imposition of secondary sanctions will also lead to a violation of specific commitments made by the United States in relation to market access, since the United States has, by virtue of its schedule of commitments, undertaken to provide no less favorable treatment to service and service suppliers of any other country than that provided for under the terms, limitations and conditions agreed and specified in its Schedule. By imposing restrictions in relation to payment for trade in services, the United States is imposing conditions in violation of its commitments in the schedule and hence violating Article XVI, GATS.

III. CAN THE UNITED STATES DEFEND THE SECONDARY SANCTIONS ON GROUND OF NATIONAL SECURITY?

In response to the above claims, the United States' prime line of defense is most likely to be based on the national security exemption under GATT, 1994 and GATS. However, it should be noted that the language of the security exemption does not categorize measures as primary, secondary or tertiary sanctions. Taking steps to maintain national security is a sovereign right of every nation and is an

³⁵ Panel Report, *Turkey - Restrictions on Imports of Textile and Clothing Products*, adopted on November 19, 1999, as modified by the Appellate Body, WT/DS34/R, para 9.63.

³⁶ GATT Panel Report, *Japan- Trade in Semi-Conductors*, adopted May 4, 1988, L/6309 - 35S/116, para 104.

³⁷ Panel Report, *India - Measures Affecting the Automotive Sector*, adopted as modified by the Appellate Body April 5, 2002, WT/DS146,175/R, para 7.261.

³⁸ Panel Report, *Argentina - Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, adopted on February 16, 2001, WT/DS/155R, para 11.17.

aspect of a member's right to self protection.³⁹ However within the GATT 1994 and GATS, this right is not an unbridled right but has to conform to the contours of Article XXI and Article XIV *bis* respectively, which deal with security exceptions.⁴⁰ In particular, Article XXI of GATT 1994 provides that a member can take any action which "it considers necessary" for the protection of its "essential security interests" – relating to fissionable materials or the materials from which they are derived; relating to traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried or directly or indirectly for the purpose of supplying a military establishment; or taken in time of war or other emergency in international relations.⁴¹ Additionally, a member can take any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.⁴² In other words, a member of the WTO can derogate from any of its obligations under the GATT 1994 if it fulfills the above mentioned criteria.

An important preliminary question to be addressed in the context of the above is whether a WTO panel can look into a dispute dealing with the defense under Article XXI or is it *a priori* prohibited from looking into such a dispute. The United States' approach during the Helms-Burton saga was along the lines that "we will not show up" since the WTO panel has "no competence to proceed".⁴³ So it will not be surprising if the United States follows the same line of argument in any potential dispute relating to the NDAA as well. However, this is an issue of extreme importance and cannot be dismissed lightly since following the United States' approach would mean that any member of the WTO can take a measure inconsistent with its obligations under the WTO and escape scrutiny by claiming a national security exception. It will not be an understatement to say that such a position will lead to opening of a Pandora's Box and the relevance of the WTO and the dispute settlement process itself may be undermined. Thus, the following sections will try to critically evaluate whether a WTO panel has the jurisdiction to look into Article XXI disputes, and if yes, is there a different standard of review that is to be followed in such cases. This will be followed by a clause-by-clause analysis of Article XXI to see whether Section 1245 of the NDAA can indeed be satisfied under any of the exceptions listed therein.

³⁹ Emmerson, Andrew, *Conceptualizing Security Exceptions: Legal Doctrine or Political Excuse?*, J.I.E.L. 2008, 11(1), 135 at 136.

⁴⁰ Due to similarity in the language of Articles XXI GATT 1994 and Article XIV *bis* GATS, this paper shall focus its discussion on Article XXI, GATT 1994. The WTO panel and Appellate Body have in the past relied on jurisprudence developed under one agreement, in case similar language is found in another agreement. For instance, when examining Article XIV of GATS relating to general exceptions, the Appellate Body found the previous decisions under Article XX of the GATT, 1994, which deals with general exceptions as well, relevant due to notable similarity in the text of the two provisions – Appellate Body Report, *United States- Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, adopted on April 20, 2005, WT/DS285/AB/R at para 291.

⁴¹ See Article XXI(b) (i) – (iii), GATT 1994.

⁴² See Article XXI(c), GATT 1994.

⁴³ See also, Sanger David, *supra* note 14.

A. Article XXI: Jurisdiction and Standard of Review

GATT and WTO practice shows that the countries have by and large observed self restraint in using the national security exception. This can be inferred from the fact that till date only a handful of cases have reached the level of formalized dispute settlement in the GATT and WTO era.⁴⁴ This is hardly surprising as national security is too sensitive a subject that countries will be comfortable submitting to an international review. One of the key issues of contention in relation to Article XXI of GATT 1994 has been the potential 'self-judging' nature of the text of Article XXI (a) and (b) since both the provisions allow countries to take measures which 'it considers' is not contrary to or is necessary for the protection of its essential security interests. This has over the years led to numerous debates and viewpoints relating to jurisdiction of a panel under Article XXI and can be broadly divided into those who believe that Article XXI defense bars a panel from proceeding with the dispute⁴⁵ and those who opine that Article XXI is not a bar to jurisdiction but rather may have a different standard of review than other provisions.⁴⁶ The following section looks into this much discussed and written about issue afresh and attempts to critically evaluate which of the two opposing views has more merit.

a. The Text and Context of Article XXI, GATT 1994

Article XXI (b) of GATT, 1994 states that nothing in the Agreement shall prevent any contracting party from taking an action which 'it considers necessary' for the protection of its essential security interests. The phrase 'it considers', which is present in Article XXI (a) as well, but absent from Article XXI (c), appears to be the crux of the argument in favour of ousting the jurisdiction of the panel in cases of national security. Bhala opines that while a non-sanctioning member has a right to bring an Article XXIII action and invoke the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) against a sanctioning member's national security sanction, the very language of Article XXI(b) will restrict a WTO panel or Appellate Body to look into the dispute.⁴⁷ However, a closer scrutiny of the text as well as the context reveals that there is no categorical bar on the panel from proceeding into an Article XXI dispute.

While Article XXI(b) does state that a member can take any action which it consider is necessary for

⁴⁴ See Schloemann and Ohloff, 'Constitutionalization' and Dispute Settlement in the WTO: National Security as an Issue of Competence, 93 Am. J. Int'l L 424, 432; The authors list the following cases as having reached a formal dispute settlement under Article XXIII, GATT 1994. Although, they do admit that the distinction among cases is arbitrary and meant to serve the sole purpose of illuminating the specific jurisdictional question. These disputes are *Czechoslovakia v. United States* in 1949, *Nicaragua v. United States* in 1984 (*Nicaragua I*), *Nicaragua v. United States* in 1985-1986 (*Nicaragua II*), and *Yugoslavia v. European Community* in 1991-1992. However, additionally, the *Helms Burton* dispute as well as the *Nicaragua-Measures affecting imports from Honduras and Columbia* can be added to the above list and are discussed in this paper as well.

⁴⁵ Bhala, Raj, *National Security and International Trade Law: What the GATT Says and What the United States Does*, 19 U. Pa. J. Int'l Escon. L. 263; Malloy, Michael, *Reconciling Political Sanctions with Globalization and Free Trade*, 4 Chi. J. Int'l L. 371 at 381 [...Article XXXI makes the decision to employ sanctions on the basis of national security a decision of the invoking state, not for the WTO – not even for academics].

⁴⁶ See Shloemann and Ohlhoff, supra note 46; Akande and Williams, *International Adjudication on National Security Issues: What Role for the WTO?*, 43 Va. J. Int'l L. 365.

⁴⁷ Bhala, Raj, *Fighting Bad Guys with International Trade Law*, U.C. Davis Law Review 1 at 16.

protection of its essential security interests, the text is clear that such action has to fulfill the specific criteria of the clause. Thus, a member does not enjoy a free run to take any action it wishes under the guise of security interest and Article XXI (b) is not wholly self judging in that respect. The very fact that there are limitations put on the self-judging nature of Article XXI(b), by inclusion of the terms 'essential', 'necessary' and sub-clauses (i) – (iii), indicates that the reviewability of any measure under the article must be carried out to ensure conformity with the article.⁴⁸ Moreover, there is no exception mentioned either in the GATT or in the DSU that states that Article XXI is outside the purview of a panel. Unless the parties otherwise agree, the panel is guided by Article 7 of the DSU which deals with the standard terms of reference and directs a panel to examine the dispute in the light of the relevant provisions cited by the parties to the disputes and to make such findings that would assist the Dispute Settlement Body.⁴⁹ Thus, there is no authority either in the text or the context of Article XXI(b), which indicates that a panel cannot look into a dispute with Article XXI defense. In fact, in principle, no matter within the scope of the WTO agreements is excluded from the jurisdiction of a panel if it is necessary or useful for the resolution of the legality of the matter.⁵⁰

Furthermore, as stated previously, the self-judging aspect of the security exception is limited to Article XXI(a) and (b) only. Since the phrase 'it considers' is absent in Article XXI(c) which deals with taking any action in pursuance of the United Nations Charter, there is absolutely no doubt that the same can be evaluated by a WTO panel.

Having established the jurisdiction of a panel on matters dealing with Article XXI, a consequential issue arises in relation to the standard of review to be adopted by the panel. Here, some divergence in views can be seen among the academic commentators although most of them agree that Article XXI is subject to a good faith review by the DSB.⁵¹ Some of the commentators opine that while paragraph (a) of Article XXI, which is mostly self-judging, may be subject to some judicial review with regard good faith; when it comes to paragraph (b), the panel has a limited authority to review 'essential security interests', but a broader authority to review whether the action taken was 'necessary' and proportional to address the situations covered in the paragraph.⁵² On the other hand, some commentators opine that the appropriate standard of review is limited to establishing whether a member genuinely considers that the measure is taken for the protection of its essential security interests and whether the member feels that the measures taken were proportionate for protection of the interests.⁵³ The second approach

⁴⁸ See Bonnan, Regis, *The GATT Security Exception in a Dispute Resolution Context: Necessity or Incompatibility?*, 19-WTR Currents: Int'l Trade L.J. 3.

⁴⁹ Article 7:1, DSU.

⁵⁰ Akande and Williams, *supra* note 48 at 380.

⁵¹ Schill and Briese, *'If the State Considers': Self-Judging Clauses in International Dispute Settlement*, Max Planck UNYB 13 (2009) 61 at 107.

⁵² See Goodman, Ryan, *Norms and National Security: The WTO as a Catalyst for Enquiry*, 2 Chi. J. Int'l L. 101 at 105; See Generally Shloemann and Ohlhoff, *supra* note 46.

⁵³ Schill and Briese, *supra* note 53 at 109; Akande and Williams, *supra* note 48 at 384-400.

appears to be narrower in nature and shows more deference to the self-judging aspect of Article XXI, compared to the first approach, though both these approaches in essence agree that the panel has powers of review on Article XXI matters. Appropriate standard of review in context of NDAA will be discussed separately in Section B below.

b. *Preparatory Work*

The discussions of the Preparatory Committee at the Geneva session, add a certain amount of ambiguity to Article XXI. One of the drafters of the original Draft Charter had stated that:

"We gave a good deal of thought to the question of the security exception which we thought should be included in the Charter. We recognized that there was a great danger of having too wide an exception and we could not put it into the Charter, simply by saying: 'by any Member of measures relating to a Member's security interests,' because that would permit anything under the sun. Therefore we thought it well to draft provisions which would take care of real security interests and, at the same time, so far as we could, to limit the exception so as to prevent the adoption of protection for maintaining industries under every conceivable circumstance. ...there must be some latitude here for security measures. It is really a question of balance. We have got to have some exceptions. We cannot make it too tight, because we cannot prohibit measures which are needed purely for security reasons. On the other hand, we cannot make it so broad that, under the guise of security, countries will put on measures which really have a commercial purpose".⁵⁴

It was also suggested in response that the spirit in which members of the Organization would interpret these provisions was the only guarantee against abuses of this kind.⁵⁵ However, in a strictly legal framework of the WTO agreements, the spirit in which the members interpret a provision is not sufficient guarantee against review by the panel and any measure taken by a member has to conform to the legal scope of the agreements.⁵⁶ Moreover, during discussion in Geneva in 1947 in connection with the removal of the provisions now contained in Article XXI, it was stated that:

"It is true that an action taken by a Member under Article [XXI] could not be challenged in the sense that it could not be claimed that a Member was violating the Charter; but if that action, even though not in conflict with the terms of Article [XXI], should affect another Member, I should think that that Member would have the right to seek redress of some kind under Article [XXIII] as it now stands. In other words, there is no exception from the application of Article [XXIII] to this or any other

⁵⁴ See *Analytical Index of the GATT*, Article XXI, available at http://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art21_e.pdf (last visited on June 29, 2012), See EPCT/A/PV/33, p. 20-21 and Corr.3; see also EPCT/A/SR/33, p. 3.

⁵⁵ See *Analytical Index of the GATT*, Article XXI, supra note 57; See EPCT/A/PV/33, p. 20-21 and Corr.3; see also EPCT/A/SR/33, p. 3.

⁵⁶ See also Shloemann and Ohlhoff, supra note 46 at 441.

Article.⁵⁷

Thus, there is some form of historical support that Article XXI defence can be reviewed by a panel.

c. *GATT and WTO practice*

There is very limited jurisprudence available in relation to the national security exception both under GATT as well as the WTO. Roger Alford argues that 'regardless of whether a future WTO panel may interpret the security exception as self judging, for the past sixty years it *has been* self-judging', on a review of state practice.⁵⁸ However, such an assertion is not without problems as the discussion below will show.

In one of the earlier disputes in 1949 concerning a *Czechoslovak*⁵⁹ complaint against the United States' national security export controls that imposed ban on export of certain products to Czechoslovak, the United States had invoked Article XXI as a defense. The Czechoslovak complaint was rejected by the contracting parties who agreed with the view of a British delegate that 'every country must have the last resort relating to its own security'.⁶⁰ However, this decision should be put in its correct historical context, as the debate on the decision reflected the beginning of cold war and the fear that it could disrupt GATT.⁶¹ Shloemann and Ohlhoff also point that when Czechoslovakia alleged that the United States' interpretation of the term 'war material' in Article XXI(b)(ii) was overly expansive, the United States' delegate replied that since only two hundred out of three thousand different group items fell under the U.S. export control regime, the allegation was without merit.⁶² According to Shloemann and Ohlhoff, this in itself was a virtual defense on the merits of the invocation of national security under Article XXI.⁶³

In another instance in 1983, the United States reduced its sugar import quota allocated to Nicaragua (*Nicaragua I*) which led to establishment of a panel under Article XXIII of GATT 1947.⁶⁴ The United States did not specifically invoke Article XXI, but did argue that the measure was beyond the scope of the GATT panel. However, it did not block the establishment or proceedings of the panel.

Soon thereafter in 1985, another dispute arose between the United States and Nicaragua over the US imposition of complete import and export embargo with Nicaragua on grounds of national security (*Nicaragua II*).⁶⁵ Nicaragua requested establishment of panel arguing violation of *inter alia*, Articles

⁵⁷ See *Analytical Index of the GATT*, Article XXI, supra note 57, See also EPCT/A/PV/33.

⁵⁸ Alford, Roger, *The Self-Judging WTO Security Exception*, 2011 Utah Law Review 697, 708 available electronically at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2079608

⁵⁹ GATT/CP.3/38.

⁶⁰ See GATT/CP.3/SR.22, Corr. 1.

⁶¹ Shloemann and Ohlhoff, supra note 46 at 433.

⁶² See GATT/CP.3/38 at 11.

⁶³ Shloemann and Ohlhoff, supra note 46 at 433.

⁶⁴ *United States – Import of Sugar from Nicaragua*, March 13, 1984, GATT B.I.S.D. (31st Supp) 67.

⁶⁵ GATT Doc. C/M/196, at 7 (1986).

I:1, II, V, XI:1, XIII GATT, 1947. However, this time around United States agreed to not block the establishment of a panel as long as the terms of reference specifically stated that the panel could not examine or judge the validity of or motivation for the invocation of Article XXI(b)(iii).⁶⁶ Thus, the panel "did not consider the question of whether the terms of Article XXI precluded it from examining the validity of the United States' invocation of the article as this examination was precluded from the mandate."⁶⁷The United States' specific insistence on removal of Article XXI from the term of reference rather weakens its position that a panel does not have the jurisdiction to look into Article XXI matters. If that was the case, then there appears to be no need for the United States to have secured *jurisdictional immunity*⁶⁸ in this manner. The panel report in this dispute was not adopted and the discussions were equally inconclusive.⁶⁹The panel however noted that:

"If it were accepted that the interpretation of Article XXI was reserved entirely to the Contracting Party invoking it, how could the Contracting Parties ensure that this general exception to all obligations under the General Agreement is not invoked excessively or for purposes other than those set out in this provision? If the Contracting Parties give a panel the task of examining a case involving an Article XXI invocation without authorizing it to examine the justification of that provision, do they limit the adversely affected Contracting Party's right to have its complaint investigated in accordance with Article XXIII:2?"⁷⁰

According to Schill and Briese, this suggests that the panel was of the view that even though its mandate was limited by the terms of reference, such a limitation was not required by the self-judging aspects of Article XXI, but merely resulted from the political compulsions of the parties.⁷¹

The Article XXI defense was raised again in 1992 when the European Communities (EC) imposed sanctions on the former Socialist Federal Republic of *Yugoslavia*.⁷²Yugoslavia claimed that the requirement of neither Article XXI(b) nor (c) were met by the EC. The EC in this case agreed to the establishment of the panel, and unlike the United States, did not insist on exclusion of Article XXI from the terms of reference. However, Yugoslavia broke up soon after and the panel discontinued its proceedings.

Thus, as can be seen from the above discussion, the practice of the Contracting Parties in the pre-WTO era was anything but conclusive on the issue of jurisdiction of panels to look into matters of national security. The situation does not become any clearer in the post-WTO period as well. Two

⁶⁶ Ibid.

⁶⁷ GATT Panel Report, *United States – Trade Measures Affecting Nicaragua*, L/6053 (October 13, 1986)

⁶⁸ Shloemann and Ohlhoff, *supra* note 46 at 435.

⁶⁹ Akande and Williams, *supra* note 48 at 376.

⁷⁰ GATT Panel Report, *United States – Trade Measures Affecting Nicaragua*, L/6053 (October 13, 1986), Para 5.17

⁷¹ Schill and Briese, *supra* note 53 at 103.

⁷² GATT Doc. L/6948 (1991).

disputes that have involved Article XXI defense have been equally inconclusive: the US-EC dispute over *Helms-Burton Act* (discussed in detail in Part I of this paper) and *Nicaragua-Measures affecting imports from Honduras and Columbia*⁷³. In the Nicaragua dispute, Nicaragua had also argued that the panel should not have the competence to consider the validity of Article XXI. Although the Dispute Settlement Body agreed to the request for establishment of panel, the panel was never constituted.

Thus, the GATT/WTO practice in relation to Article XXI, does not in any way indicate that a panel *does not* possess the requisite competence to look into issues of security exception.

d. *Conclusion:*

It can be seen on a consideration of the totality of factors that while in some respects, Article XXI's interpretation is far from unambiguous, however taking into account the text and context, the preparatory documents and the limited available jurisprudence, it can be safely concluded that Article XXI can be reviewed by a panel, although the exact standard of review may vary.

B. NDAA and Article XXI, GATT 1994

As stated at the start, one of the distinctive features of sanctions under the NDAA is that the sanctions are secondary in nature, where the primary target of the sanction is Iran and not the country to which the foreign financial institutions belong to. Apart from the *Helms Burton* dispute, another instance relating specifically to secondary boycotts had arisen at the time of the accession of the United Arab Republic (erstwhile Egypt) to GATT, when concerns were raised regarding the UAR's primary boycott against Israel and the secondary boycott against firms having relation with Israel. In response, the UAR representative stated that 'in view of the political character of this issue, the UAR did not wish to discuss it within GATT'.⁷⁴ Several members of the working party supported the views of the representative of the UAR that the background of the boycott measures was political and not commercial.⁷⁵

Similar questions arose at the time of the accession of Saudi Arabia in 2005, since it had also imposed secondary sanctions in relation to Israel. Eugene Kontorovich observed with respect to the *Working Party Report on "Accession of the United Arab Republic"* that a 'single thirty year old informal precedent – itself controversial at the time – can hardly establish a broad principle legitimizing any foreign policy restrictions'.⁷⁶ Thus there is not much support available for the view that political or commercial objective behind a boycott is required to be taken into consideration, in place of the requirements listed in Article XXI, to evaluate whether an Article XXI exception has been validly invoked. Moreover, during the Argentina – Falkland crisis, arising out of a territorial dispute between

⁷³ WT/DS188/2 (March 28, 2000).

⁷⁴ Working Party Report on "Accession of the United Arab Republic" L/3362, adopted on February 27, 1970

⁷⁵ See *Analytical Index of the GATT*, Article XXI, supra note 57, at 603.

⁷⁶ See Kontorovich, Eugene, *The Arab League Boycott and WTO Accession: Can Foreign Policy Excuse Discriminatory Sanctions?*, 4 Chi. J. Int'l L. 283 at 296.

the United Kingdom and Argentina, Argentina had sought an interpretation of Article XXI, resulting in the *Ministerial Declaration of November 1982*, which stated that "...contracting parties undertake, individually and jointly:...to abstain from taking restrictive trade measures, for the reasons of non-economic character, not consistent with the General Agreement".⁷⁷

In the following sections, the provisions of NDAA will be evaluated against the criteria of Article XXI to see if they are validly covered under any one of them. For the sake of convenience, the analysis will start with Article XXI(c) and then proceed to Article XXI(b), GATT, 1994.

a. Article XXI (c): 'action in pursuance of United Nations Charter for maintenance of international peace and security'

Risks related to Iran's proliferation of its nuclear programme, has been a growing concern at the United Nations Security Council. Since 2006, several rounds of sanctions have been imposed against Iran and the Security Council has adopted resolutions 1696 (2006)⁷⁸, 1737 (2006),⁷⁹ 1747 (2007),⁸⁰ 1803 (2008),⁸¹ 1835 (2008),⁸² 1887 (2009)⁸³ and 1929 (2010)⁸⁴ due to the continuing failure of Iran to meet the requirements of the International Atomic Energy Agency (IAEA).

While a WTO panel or Appellate Body cannot review a Security Council resolution, they do have the jurisdiction to examine that the security measure adopted by a member does not exceed the scope of Security Council resolution.⁸⁵ Thus, it becomes imperative to examine whether secondary sanctions under the NDAA derive their force from the Security Council resolutions relating to Iran. The potential link between the Iran's energy sector and the proliferation of nuclear weapons was recognized in the preamble of resolution 1929 (2010) resolution, which states that:

"*Recognizing* that access to diverse, reliable energy is critical for sustainable growth and development, while noting that the potential connection between Iran's revenues derived from its energy sector and the funding of Iran's proliferation-sensitive nuclear activities, and *further noting* that chemical process equipment and materials required for the petrochemical industry have much in common with those required for certain sensitive fuel cycle activities."⁸⁶

However, notwithstanding the text in the preamble, the operative part of the resolution does not

⁷⁷ *Decision Concerning Article XXI of the General Agreement*, adopted by the contracting parties on November 30, 1982 as cited in *Analytical Index of the GATT*, Article XXI, supra note 57 at 603.

⁷⁸ S/RES/1696 (2006).

⁷⁹ S/RES/1737 (2006).

⁸⁰ S/RES/1747 (2007).

⁸¹ S/RES/1803 (2008).

⁸² S/RES/1835 (2008).

⁸³ S/RES/1887 (2009).

⁸⁴ S/RES/1929 (2010).

⁸⁵ Cottier and Delimatsis, 'Article XIV bis GATS', *WTO – Trade in Services* (Wolftrum and Stoll *et al* (ed)), Max Planck Commentaries on World Trade Law, 329 at 345.

⁸⁶ S/RES/1929 (2010).

prescribe or recognize imposition of sanctions of a secondary nature on foreign financial institutions involved in the energy sector of Iran. This raises important issues relating to interpretation of a Security Council resolution. In the International Court of Justice's 1971 *Namibia* Advisory opinion, it was opined that:

"The language of a resolution of the Security Council should be carefully analysed before a conclusion can be made as to its binding effect. ... the question whether they have been in fact exercised is to be determined in each case, having regard to the terms of the resolution to be interpreted, the discussions leading to it, the Charter provisions invoked and, in general all circumstances that might assist in determining the legal consequences of the resolution of the Security Council".⁸⁷

According to Michael Wood, the preamble to a Security Council resolution "may assist in interpretation, by giving guidance as to the object and purpose, but they *need to be treated with caution since they tend to be used as a dumping ground for proposals* that are not acceptable in the operative paragraphs. And there is no conscious effort to ensure that the object and purpose of each operative provision is reflected in the preamble."⁸⁸ Thus, the mere fact that the preamble to resolution 1929 (2010) recognizes a potential link between Iran's earnings from the energy sector and the proliferation of nuclear weapons, this is not in itself sufficient to impose secondary sanctions on financial institutions dealing with Iran's petroleum and petroleum products.

Furthermore, additional guidance can be sought from the two specific sanctions permitted under resolution 1929 (2010) in relation to financial institutions, which are re-produced below:

"The *Security Council*

.....

"21. *Calls upon* all States... to prevent the provision of financial services, including insurance or re-insurance, or the transfer to, through, or from their territory, or to or by their nationals or entities organized under their laws (including branches abroad), or persons or financial institutions in their territory, of any financial or other assets or resources if they have information that provides reasonable grounds to believe that such services, assets or resources could contribute to Iran's proliferation-sensitive nuclear activities..."

"24. *Calls upon* States to take appropriate measures that prohibit financial institutions within their territories or under their jurisdiction from opening representative offices or subsidiaries or banking accounts in Iran if they have information that provides reasonable grounds to believe that such financial services could contribute to Iran's proliferation-sensitive nuclear activities or the development of nuclear weapon delivery systems." ⁸⁹ (emphasis provided)

⁸⁷ See *Legal Consequences for States of the Continued Presence of South Africa in Namibia (South-West Africa) Notwithstanding Security Council Resolution 276 (1970)*, Advisory Opinion of 21 June 1971, ICJ Reports 1971, 53.

⁸⁸ Michael C. Wood, *Interpretation of Security Council Resolutions*, Max Planck Yearbook of United Nations Law (1998), available at www.mpil.de/shared/data/pdf/pdfmpunyb/wood_2.pdf (last visited on June 28, 2012).

⁸⁹ See Resolutions 21 and 24, S/RES/1929 (2010).

Though the above resolutions are not in context of Iran's energy sector, a common thread between the two resolutions is that both permit imposition of sanctions relating to financial institution in the territory or under the jurisdiction of the sanctioning country and not specifically on financial institutions which are foreign entities i.e. the foreign financial institutions.⁹⁰ Broadly, the resolutions provide that if such a financial institution *uses* the territory of the sanctioning country in such a manner as to provide services etc to Iran that leads to proliferation of nuclear weapons there, they can be subject to sanctions. Thus there is a nexus between the financial institution's action in the territory of the sanctioning country and proliferation of nuclear weapons in Iran. This indicates that even in relation to sanctions that are specifically permitted for financial institutions under the above resolution, imposition of secondary sanctions of the nature envisaged by the United States under Section 1245(d) (4) of NDAA are not prescribed in the resolution.⁹¹ In the present instance, foreign financial institutions which are engaged in regular international transactions with the United States are proposed to be made subject to the sanctions.

b. Article XXI(b): 'it considers necessary' for the protection of 'essential security interests'

Having established that Section 1245 of the NDAA cannot be justified by the United Nations Security Council Resolutions, it has to be now evaluated whether Section 1245 is saved by any of the criteria listed in Article XXI(b). Article XXI(b) allows a member to take a measure if it falls within any one of the criteria listed in (i) to (iii), and if it fulfills the requirement of the chapeau of Article XXI(b). Taking guidance from the interpretation of Article XX, ⁹² which follows a similar structure comprising of a chapeau and specific exceptions within the article, the below analysis will adopt the following order of analysis, namely: a) examination if the measure falls within one of the recognized exceptions under (i) to (iii), in order to enjoy provisional justification, and b) examination if the measure meets the requirement of the chapeau of Article XXI(b).

a) Provisional Justification of measure

i. Relating to fissionable material⁹³

Section 1245 imposes sanction with respect to the financial sector of Iran because of the threat to government and financial institutions resulting from illicit activities of the Government of Iran, including its pursuit of nuclear weapons, support for international terrorism and efforts to deceive responsible financial institutions and evade sanctions.⁹⁴

In the present instance, the United States' measure is only *partially* justified by Article XXI(b)(i), as

⁹⁰ Refer to the definition of 'foreign financial institution' which is defined as a 'foreign entity' in note 19 above.

⁹¹ Similarly, secondary sanctions under section 1245(d)(1), NDAA, involving foreign financial institutions conducting or facilitating any significant financial transaction with the Central Bank of Iran or another Iranian financial institution will also not be covered by the Security Council Resolutions.

⁹² Report of the Panel, *Argentina – Bovine Heads*, supra note 40, Para 11.288 -11.289.

⁹³ Article XIV *bis*, GATS mentions both fissionable and fusionable materials.

⁹⁴ See Sec 1245(b), NDAA (22 USC Sec. 8513a(b)).

this sub-clause is specific only to those measures that relate to fissionable material. Thus, since one of the objectives of the NDAA is stalling proliferation of nuclear weapons, this objective can be justified under Article XXI(b)(i), while the rest are not saved by this provision.

ii. Relating to traffic in arms, ammunition and implements of war etc.

One of the underlying objectives of the NDAA is to curb support for international terrorism, and to that extent, on a liberal interpretation of Article XXI(b)(ii), United States' measure can be partially justified, since traffic in arms, ammunition and implements of war are one of the aspects of international terrorism.

iii. Taken in time of war or other emergency in international relations

One of the most controversial aspect of Article XXI(b) is the permission to invoke the exception in the time of war or other emergency in international relations. A prevailing view with respect to this provision is that if it is up to the concerned WTO member to unilaterally determine whether there is a war or other international emergency, then the scope for abuse of the article will be very high.⁹⁵ While it is widely accepted that procedurally a panel has the right to review a measure taken under this provision, there is no uniformity or clarity as to how the substantive terms of the provision should be interpreted.⁹⁶

In the present context, the United States had declared emergency with respect to Iran as early as in 1979.⁹⁷ However, through an executive order in 1995, a separate national emergency against Iran was issued prohibiting certain transactions with respect to development of Iranian petroleum resources.⁹⁸ On March 16, 2012, the United States announced the continuation of this national emergency with respect to Iran, by Executive Order 12957 for another year, because the actions and policies of the government of Iran continue to pose an unusual and extraordinary threat to the national security, foreign policy and economy of the United States.⁹⁹ Thus, *prima facie*, due to declaration of an emergency with respect to Iran, the measure of the United States can be satisfied under clause (iii) of Article XXI(b), GATT 1994, although this will be subject to review of a panel, and it will have to satisfy the conditions of the chapeau relating to necessity and 'essential security interests'. The United States will have to show that its measure, i.e. NDAA, which also has prevention of money laundering as one its main objectives, is required for protection of United States' essential security interest.

⁹⁵ Akande and Williams, *supra* note 48 at 400.

⁹⁶ Shloemann and Ohlhoff, *supra* note 46 at 446.

⁹⁷ Executive Order 12170, November 14, 1979, 44 FR 65729, available online at <http://www.archives.gov/federal-register/codification/executive-order/12170.html> (last visited on June 28, 2012).

⁹⁸ Executive Order 12957, March 15, 1995, available online at <http://www.treasury.gov/resource-center/sanctions/Documents/12957.pdf> (last visited on June 28, 2012).

⁹⁹ Copy of the Presidential Document, dated March 13, 2012 is available online at <http://www.gpo.gov/fdsys/pkg/FR-2012-03-14/pdf/2012-6426.pdf> (last visited on June 28, 2012)

It should be noted that the term 'emergency' has to be interpreted in the context of the Article XXI(b), which sets a standard that has to be met by a member, and is not defined unilaterally.¹⁰⁰ It has also been argued that the emergency situation that a member claims has to be as significant as the 'time of war', as the word 'other' between the two elements suggests.¹⁰¹ Thus, this indicates that any 'other' situation will be covered by this exception if there is *comparable gravity* and a threat that is *imminent*; or the measure is in *response* to a situation that arose suddenly and recently.¹⁰² Hence, merely a formal declaration of emergency is not sufficient to be covered under this exception. Considering that the United States' emergency in relation to Iran has been in operation for several years now, the United States will have to demonstrate before a panel that the situation is comparable to a war and there is existence of imminent threat to it from Iran.

b) Examination with respect to chapeau

Although the chapeau of Article XXI(b) leaves it to the members to take steps which it considers necessary, guidance on what is 'necessary' can be taken from Article XX, where considerable jurisprudence exists on the matter. Trade restrictions will be considered 'necessary' if there are no alternative measures consistent with the GATT, or less inconsistent with it, available to the United States to achieve its objectives.¹⁰³ Thus, though under Article XXI, the members will determine what is 'necessary' for them to attain security objectives, in case a dispute is brought to the WTO, the member invoking the exception will have to demonstrate that there was no alternative GATT consistent measure available.¹⁰⁴

Furthermore, the use of phrase 'essential' security interest indicates that the measure taken under Article XX cannot be for protection of all security interests, but rather those security interests which are absolutely 'essential' for United States in relation to sub-clauses (i) to (iii) of Article XXI(b) and can be reviewed by the panel. Although no WTO panel/Appellate Body jurisprudence exists on this issue, in a dispute before the International Court of Justice (ICJ), the ICJ had rejected the United States' claim that the national security exception of a 1955 US-Iranian treaty barred the jurisdiction of the ICJ to look into the matter.¹⁰⁵ The ICJ rejected the United States' claim and held that questions of

¹⁰⁰ See Shloemann and Ohlhoff, *supra* note 46 at 446.

¹⁰¹ Cottier and Delimatsis, *supra* note 87 at 344, where the phrase is discussed in context of GATS; See also Shloemann and Ohlhoff, *supra* note 46 at 446.

¹⁰² Cottier and Delimatsis, *supra* note 87 at 344.

¹⁰³ See Generally Appellate Body Report, *United States – Standards for Reformulated Gas and Conventional Gasoline*, adopted on May 20, 1996, (WT/DS2/AB/R).

¹⁰⁴ See Browne, Rene, *Revisiting 'National Security' in an Interdependent World: The GATT Article XXI Defense after Helms-Burton*, 86 Geo. L.J. 405 at 426; cf Akande and Williams, *supra* note 48 at 386-389.

¹⁰⁵ See *Oil Platforms (Islamic Republic of Iran v United States of America)*, Preliminary Objection, Judgment, 1996 I.C.J. 803 (December 12, 1996); See also Clark and Wang, *Foreign Sanctions Countermeasures and other Responses to the U.S. Extraterritorial Sanctions*, Dewey Ballantine LLP, August 2007.

what constituted 'essential security interests' were matters subject to treaty interpretation.¹⁰⁶ It has been suggested that a panel can review a state's determination of its security interests and should apply a test of proportionality to examine the reasonableness of the measure in the context.¹⁰⁷

This raises questions whether the measure of imposing secondary sanctions on foreign financial institutions is proportionate to the security risk that the United States faces from Iran and whether there is any alternative GATT/GATS consistent measure reasonably available to the United States. The United States proposal to cut-off financial institutions of third countries that have legitimate trade interests with Iran to protect its national security, appears to be neither proportionate nor the only GATT-consistent option available to the United States to protect its security interests. While there exists a view that in certain scenarios a WTO member can take actions with extraterritorial reach as was implicitly recognized in the *US-Shrimps*¹⁰⁸ dispute¹⁰⁹, extending the same argument to national security exception is fraught with serious implications and subject to abuse. Furthermore, in the *Decision Concerning Article XXI of the General Agreement*, adopted by the contracting parties on November 30, 1982¹¹⁰, it was recognized that in taking action in terms of the exceptions provided in Article XXI of the GATT, countries *should* take into consideration the interests of third parties which may be affected. Secondary sanctions taken by the United States under NDAA clearly disregard the interests of third parties by unilaterally requiring them to curtail their petroleum and petroleum product trade with Iran if they wish to remain connected to the United States' banking system. Imposition of secondary sanctions on foreign financial institutions conducting or facilitating purchase of petroleum or petroleum products with Iran appears to be thus disproportionate to the threatened security interest of the United States and would not pass the test of reasonableness. Thus, there is a strong likelihood that a WTO panel may conclude that the United States' imposition of secondary sanctions under Article XXI is not justified.

IV. CONCLUSION

The United States' National Defense Authorization Act of 2012 attempts to influence the dealings of foreign financial institutions in relation to purchase of Iranian petroleum and petroleum products. By proposing to impose sanctions that impact the ability of the foreign financial institution to connect with the American banking channels, the United States is effectively trying to prevent the country with primary jurisdiction over the foreign financial institutions from conducting any trade in USD. With the United States as well as the major Iranian oil importing countries being members of the

¹⁰⁶ See *Oil Platforms (Islamic Republic of Iran v United States of America)*, Judgment, 2003 I.C.J. rep 161 (November 6, 2003).

¹⁰⁷ Shloemann and Ohlhoff, *supra* note 46 at 445.

¹⁰⁸ Report of the Appellate Body, *United States - Import Prohibition of Certain Shrimp And Shrimp Products*, adopted on November 6, 2008, WT/DS58/AB/R.

¹⁰⁹ See Cottier and Delimatsis, *supra* note 87 at 341.

¹¹⁰ See *Analytical Index of the GATT*, Article XXI, *supra* note 57 at 605.

WTO, important legal issues arise out of the whole situation. WTO is well known to be based on the principle of non discrimination and recognizes tariffs to be the legitimate means to restrict market access. With the United States now discriminating between countries importing oil and those not importing from Iran as well as imposing a *de facto* prohibition on trade from the countries of the foreign financial institution, it appears to be disregarding these two cornerstones of the multilateral trading system. Thus, an analysis of the conformity of the proposed United States sanctions becomes crucial in the current times.

The analysis has shown that the United States is indeed violating Articles I and XI of GATT 1994 and Articles II and XVI of GATS. Furthermore, the recourse to Article XXI of GATT and Article XVI *bis* GATS does not appear to be available. Article XXI of GATT has generated a lot of debate among the members as well as academic commentators in relation to both competence of the panel to evaluate a defense under the said Article and the standard of review in case the answer to the previous issue is affirmative. The present analysis shows that there is indeed no bar on the competence of the panel to look into a matter with Article XXI defense, though the standard of review varies depending upon the particular provision that is being reviewed. In the present instance, it appears that some components of Section 1245 of NDAA (*viz.* relating to the objective to check money laundering risks for the global financial system) are not covered by Article XXI(b)(i) and (ii). However, with the United States having declared a national emergency in relation to Iran, Section 1245 of NDAA can be *prima facie* saved by Article XXI(b)(iii), although this is subject to review of a panel and will still have to satisfy the conditions mentioned in the chapeau of Article XXI(b). Secondary sanctions proposed by the United States appear to go beyond the scope of the chapeau of Article XXI(b), on grounds of proportionality and disregard for the interest of third parties. Thus a possible case can be made out against the United States in relation to Section 1245 of NDAA, since its measure appears to contravene its obligations under the WTO and is not deriving a clear benefit from the security exception under either GATT, 1994 or GATS.