China Issues New Rules on Counteracting Extra-territorial Application of Unjustified Foreign Legislation and Other Measures

By Llinks Corporate & Compliance Practice Group

On January 9, 2021, as approved by the State Council, the Minister of Commerce (MOFCOM) issued the *Rules on Counteracting Unjustified Extra-territorial Application of Foreign Legislation and Other Measures* (hereinafter referred to as the "**Rules**"). The Rules prescribe a reporting mechanism that applies where the extra-territorial application of foreign legislation and other measures unjustifiably prohibits or restricts the citizens, legal persons or other organizations of China (hereinafter referred to as "**Chinese persons**") from engaging in economic and trade activities with a third State, as well as remedies to ensure Chinese persons' legitimate rights.

1. Purpose and legal basis

Article 1 articulates the purpose and legal basis of the Rules. The upper-level law of the Rules is the *National Security Law* and other relevant laws. As a departmental regulation in the national security legal system, the core purpose of the Rules is safeguarding national sovereignty and security. National security has rich contents, including political power, sovereignty, unity and territorial integrity, and sustainable social and economic development, covering political, economic, military, and cultural and social security. For example, the Office of Foreign Asset Control, Department of Treasury of the United States (OFAC) sanctions Chinese persons on the basis of long-arm jurisdiction, aiming to deter the development of China's advanced technology and leading companies, which poses serious threat to China's national security and development. Meanwhile, trade restrictions imposed in the unjustified extra-territorial application of

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foreign legislation and other measures seriously endanger the legitimate rights of Chinese persons in economic and trade activities. The Rules aim to counter such restrictions and protect the legitimate rights of the Chinese persons, and provide viable remedies.

2. Scope of application

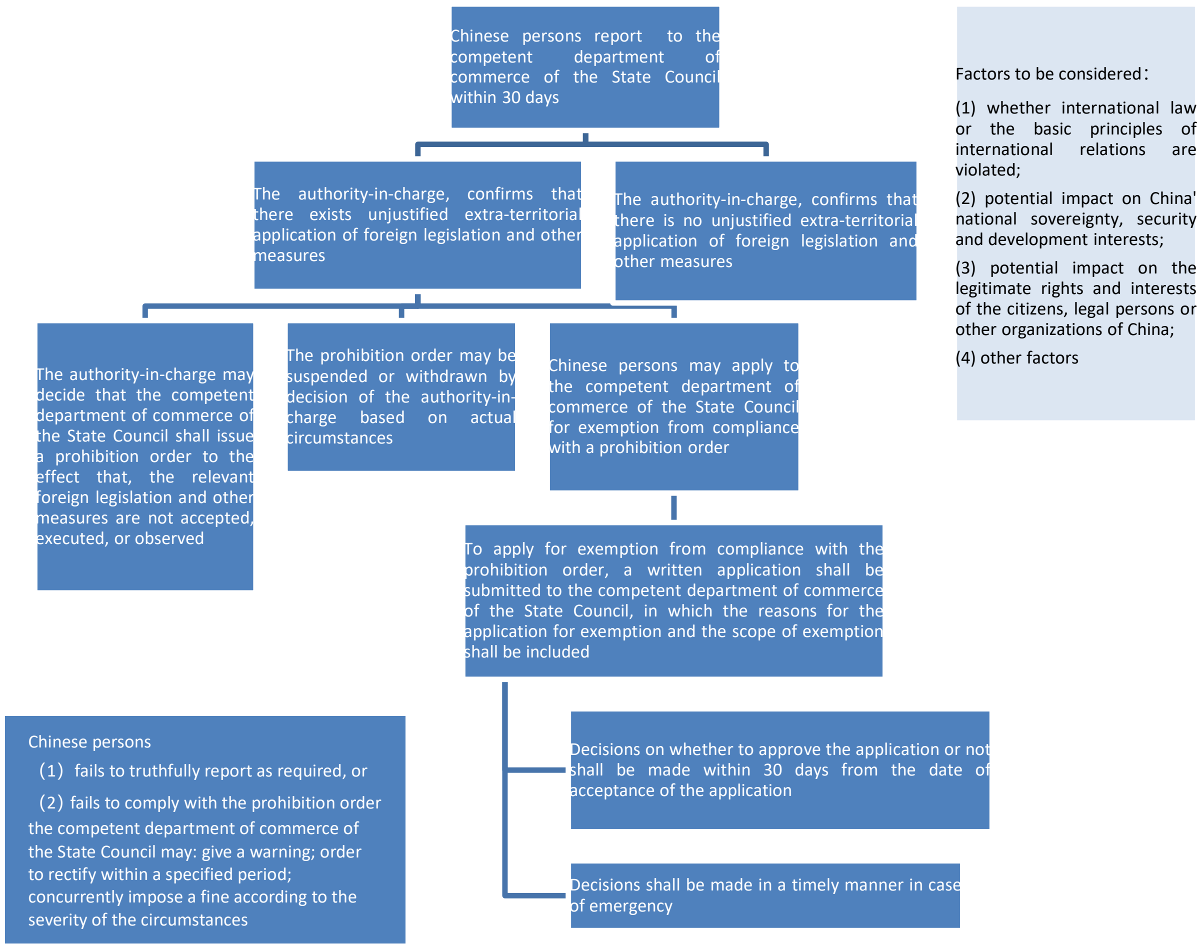
According to Article 2 of the Rules, the Rules apply where the extra-territorial application of foreign legislation and other measures is in violation of international law and the basic principles of international relations, and unjustifiably prohibits or restricts Chinese persons from engaging in normal economic, trade and related activities with a third State (or region) or its entities. In summary, foreign legislation and other measures counteracted by the Rules shall meet two material requirements: (1) in violation of international law and the basic principles of international relations; (2) unjustifiably prohibits or restricts Chinese persons from engaging in normal economic, trade and related activities.

We believe that the Entity List and the Specially Designated Nationals and Blocked Persons List (hereinafter referred to as the "**SDN List**"), which are commonly used on Chinese persons by the U.S., may fall within the scope of application of the Rules. The Bureau of Industry and Security (BIS) of the U.S. Department of Commerce frequently adds Chinese enterprises and universities to the Entity List for violations of national security of the U.S., and restricts controlled products, technologies and services (collectively referred to as "**items**") to be transferred to these Chinese persons. It not only prohibits U.S. entities from exporting controlled U.S. items to Chinese persons on the Entity List, but also prohibits entities in other countries from exporting, re-exporting, and transferring (in country) controlled items to these Chinese persons, even if the controlled items and all parties are located outside the U.S. Another example is the addition of many Chinese citizens and enterprises on the SDN List. U.S. entities and foreign entities that have connections with the U.S. (e.g. using U.S. financial systems or communication tools) are prohibited from transactions such as import and export, investment and financing with Chinese persons on the SDN List. Certain Chinese persons on the SDN list are also subject to secondary sanctions administered by OFAC. A foreign person is prohibited to conduct transactions with the entities on the SDN List even if it is not connected with the U.S. Non-U.S. persons or transactions not conducted in the U.S are governed by the long-arm jurisdiction of U.S. law through the Entity List and the SDN List and the laws and regulations on which they are based. Secondary sanctions are widely criticized by the international community because they do not conform to the general principles of international law. However, many foreign entities still comply with related laws for fear of U.S. sanctions.

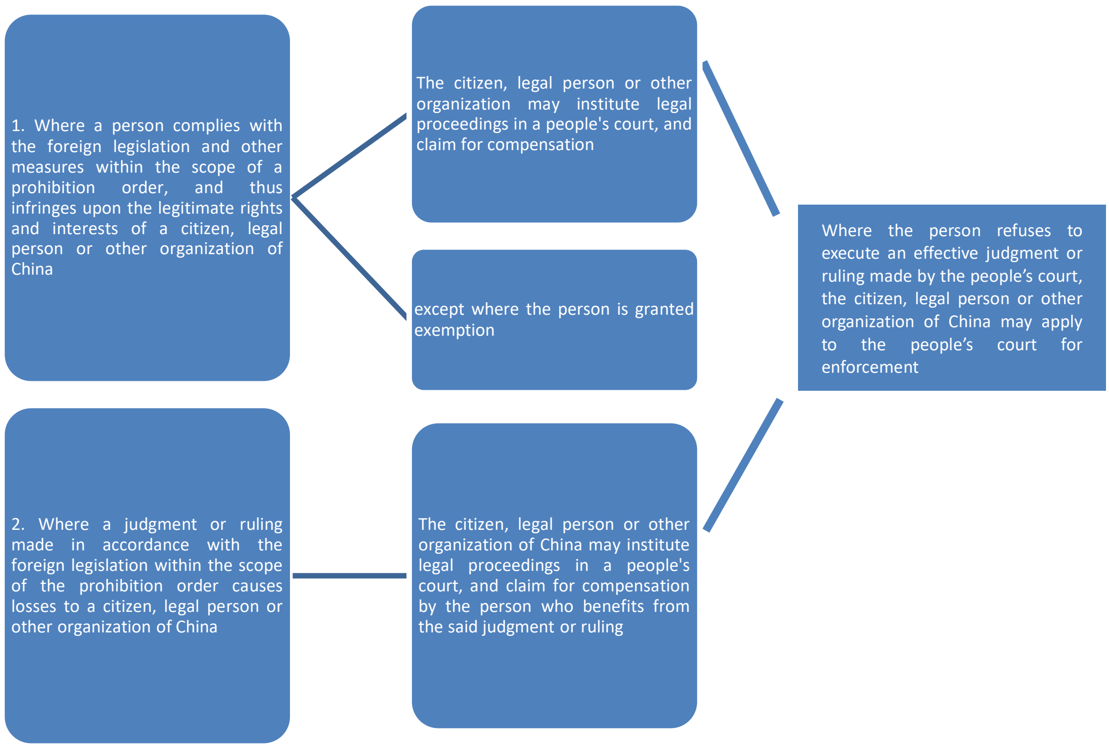
[For more details about the Entity List and the SDN List, please refer to our article *Overview and Compliance Advice of U.S. Sanctions against Chinese Enterprises* (available in Chinese only)]

3. Implementation Mechanism

(1) Prohibition Order



(2) Judicial remedies



4. Powers and responsibility of PRC authority

According to the Rules, the authority-in-charge is composed of relevant central government departments and is responsible for counteracting unjustified extra-territorial application of foreign legislation and other measures. The authority-in-charge is led by the MOFCOM, and the specific matters are handled by the MOFCOM, the National Development and Reform Commission and other relevant departments of the State Council. Similarly, according to the *Provisions on the Unreliable Entity List* issued by the MOFCOM in September 2020 [For more details on the Unreliable Entity List, please refer to our article *A Glimpse of Provisions on the Unreliable Entity List*], the authority in charge of the implementation of the unreliable entity list system also has its office in the MOFCOM. In the future, it is likely that the same authority will coordinate, organize, and implement for counteracting unjustified extra-territorial application of foreign legislation and other measures and the administration of the Unreliable Entity List.

(1) Assess whether unjustified extra-territorial application of foreign legislation and other measures exists

According to the Rules, when assessing whether there exists unjustified extra-territorial application of foreign legislation and other measures, the authority will take the following factors into account: 1) whether international law or the basic principles of international relations are violated; 2) potential impact on China's national sovereignty, security and development interests; 3) potential impact on the legitimate rights and interests of the citizens, legal persons or other organizations of China; and 4) other factors that shall be taken into account.

As explained by a representative from the Department of Treaty and Law of the MOFCOM in a press conference, "when assessing and determining whether unjustified extra-territorial application of foreign legislation and other measures exists, the authority will comprehensively consider the factors stipulated in Article 6 of the Rules, and prudently evaluate and determine in accordance with the law based on specific circumstances".[1] The "specific circumstances" of foreign laws and measures may include both the promulgation procedures and the substantive content of such laws or measures. Therefore, companies concerned should keep a close eye to the development of the authority and better understand the assessment.

(2) Decide to issue, suspend, and withdraw prohibition order

After assessment, if the authority confirms that there is unjustified extra-territorial application of foreign legislation and other measures, it may order the competent department of commerce of the State Council to issue a prohibition order to declare that relevant foreign legislation and other measures are not accepted, executed, or observed. The prohibition order may be suspended or withdrawn by the authority depending on changing circumstances. Such "circumstances" may include the repeal or revision of foreign legislation or measures.

[1] The press conference with regards to the *Rules on Counteracting Unjustified Extra-territorial Application of Foreign Legislation and Other Measures*
http://www.mofcom.gov.cn/article/news/202101/20210103029779.shtml

(3) Guidance and services

According to the Rules, members of the authority shall, in accordance with their respective functions and duties, provide guidance and services for Chinese persons in response to unjustified extra-territorial application of foreign legislation and other measures. The members may include the MOFCOM, the National Development and Reform Commission, the General Administration of Customs, the Ministry of Foreign Affairs, the State Taxation Administration, and State Administration for Market Regulation. During the implementation of the Rules, these departments may provide guidance on the unjustified extra-territorial application of foreign legislation and other measures by issuing regulations, regulatory documents, and Q&A.

5. Issues to be clarified

(1) Scope of the Rules

We understand that foreign legislation and other measures that unjustifiably prohibit or restrict economic and trade activities between Chinese persons, shall also fall within the scope of the Rules. Take the SDN list as an example. Chinese persons are not allowed to deal with Chinese persons who are subject to secondary sanctions. The Rules exclude such a scenario from the application scope, consequently weakening the effect of counteracting unjustified application of those foreign legislation and measures.

Moreover, it is unclear whether “a third State (or region) or its citizens, legal persons or other organizations” under Article 2 of the Rules includes overseas affiliates of enterprises based in countries that unjustifiably apply legislation and other measures. Again, taking the SDN list as an example, in addition to U.S. entities, foreign entities under the control of U.S. entities identified under OFAC control rules are also prohibited from trading with SDN listed entities. It remains to be clarified whether those “foreign entities under the control of U.S. entities” are “a third State (or region) or its citizens, legal persons or other organizations” as specified in the Rules.

(2) “Prohibited or restricted by foreign legislation and other measures”

Article 5 of the Rules stipulate the reporting obligation of Chinese persons: “where a citizen, legal person or other organization of China is prohibited or restricted by unjustified extra-territorial application of foreign legislation and other measures, he/it shall truthfully report such matters to the competent department of commerce of the State Council within 30 days.” Failure to report in a timely manner may result in administrative penalties. The notion "prohibited or restricted by foreign legislation and other measures" needs further clarification. The forms of suspected unjustified extra-territorial application of foreign legislation and other measures include without limitation laws and regulations, judgments, rulings, decisions, and administrative orders. Questions arise as to whether the date of "prohibited or restricted" refer to 1) the date of promulgation/effectiveness of laws and regulations, 2) the date of judgment/effectiveness of final judgments, or 3) the date when Chinese persons became aware of such foreign legislation and measure?

(3) "Person who benefits from the said judgment or ruling"

According to Article 9 of the Rules, where a judgment or ruling made in accordance with the foreign legislation within the scope of the prohibition order causes losses to a citizen, legal person or other organization of China, the latter may, in accordance with law, institute legal proceedings in a people's court, and claim for compensation by the person who benefits from the said judgment or ruling. First of all, "the said judgment or ruling" here refers to which meaning of the followings: 1) the judgment or ruling made by the court or arbitration institution located in the country that unjustifiably applies the legislation and other measures in accordance with the foreign legislation within the scope of the prohibition order, 2) the judgment or ruling made by a third State court or arbitration institution in accordance with the foreign legislation within the scope of the prohibition order, or 3) the judgment or ruling that are adverse to Chinese persons made by a third State court or arbitration institution in accordance with the third State's legislation. Second, how to define "benefit"? Provided that a third State person refuses to trade with Chinese enterprises in accordance with the U.S. sanctions laws and wins the judgment regarding exempting from liability for breach of contract, but no profits are gained from the unjustified extraterritorial application of U.S. sanctions laws. Under such circumstance, is such person obligated to compensate the losses of the Chinese enterprise?

(4) "Necessary support"

Article 11 of the Rules provides that where, in adherence to the prohibition order, a Chinese person suffers significant losses resulting from non-compliance with the relevant foreign legislation and other measures, relevant government departments may provide necessary support based on specific circumstances. The phrase of "necessary support" is vague. We understand that the "necessary support" in Article 11 of the Rules is of great significance and provides a fundamental institutional guarantee for counteracting the unjustified extraterritorial application of foreign legislation and other measures. We look forward to supporting regulations and measures or law enforcement practices to be issued to clarify its implication as soon as possible.

6. Conclusion

In recent years, Chinese persons frequently encounter unjustified extraterritorial application of foreign legislation and other measures, in the course of engaging in in international economic and trade activities. The timely promulgation of the Rules reflects the Chinese government's opposition to the unjustified application of legislation or policies to destroy the multilateral trading system and harm the interests of other countries. In this regard, the Rules protect the legitimate economic and trade activities of Chinese persons. "The sword is out of the sheath". The Rules show the Chinese government's consistent determination to proactively safeguard international rules and defend the interests of the country and its enterprises. Prior to the promulgation of the Rules, China has promulgated the *Provisions on the Unreliable Entity List*, the *Export Control Law*, and the *Measures on Security Review of Foreign Investment*.

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