

China Policy Premium Update – 15 January 2021

## WHAT ARE CHINA'S NEW BLOCKING RULES?

By Joseph Cash, CBBC Analyst

- China has introduced new measures designed to protect its companies and citizens from the effect of foreign laws applied extra-territorially, such as sanctions
- UK companies doing business with Chinese companies outside of the U.S. could be called before PRC courts if they move to comply with U.S. sanctions to the detriment of their Chinese partner
- The CBBC will proactively monitor how the new measures are implemented because they contain a number of ambiguous clauses

### Summary

On Saturday 9<sup>th</sup> January, China's Ministry of Commerce (MOFCOM) promulgated new *Rules on Counteracting the Unjustified Extra-Territorial Application of Foreign Legislation and Other Measures* ('the Measures'), with the rules coming into effect immediately.<sup>1</sup>

The Measures are the latest arrow in China's quiver of trade defence instruments introduced over the last year – primarily in response to escalating trade tensions with the U.S. They have been designed to protect against the effects of the extra-territorial application of foreign laws that China believes bring harm to the interests of its companies and citizens.

Simply speaking, the Measures are designed to dissuade Chinese and foreign companies from complying with laws such as sanctions in markets that are outside of the sanctioning country. For example, British or Chinese companies that comply with U.S. sanctions against Chinese companies in markets *outside* of the U.S. may find themselves falling foul of China's new measures.

The Measures are expected to work in tandem with China's *Unreliable Entity List* and the new *Measures for Security Review of Foreign Investment*. The *Unreliable Entity List* was announced and came into effect in September, and foreign companies that find themselves on the list will be restricted or banned from trading with China. The *Measures for Security Review of Foreign Investment* will come into effect from 18<sup>th</sup> January, and will subject foreign direct and indirect investments in currently undefined "key" sectors to a security review.<sup>2</sup>

### Background

China's introduction of these Measures isn't surprising: A number of other markets, such as the EU, Canada, and Mexico, already have similar blocking rules in force.

That said, it is noteworthy that the Measures have taken effect immediately – without undergoing the normal 30-day public consultation period China normally honours when introducing foreign-related measures – and so soon after the Trump

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<sup>1</sup> Text of the *Measures*: <http://english.mofcom.gov.cn/article/policyrelease/announcement/202101/20210103029708.shtml>.

<sup>2</sup> Text of the *Unreliable Entities List*:

<http://english.mofcom.gov.cn/article/policyrelease/questions/202009/20200903002580.shtml>; Text of the *Measures for*

*Security Review of Foreign Investment*: [https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202012/t20201219\\_1255025.html](https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202012/t20201219_1255025.html) [Chinese]

administration announced fresh trade sanctions. The move demonstrates that Beijing is taking a highly proactive approach to defending its trade interests.

The Measures appear to target *secondary sanctions*. To take a hypothetical example: were a British company to cut ties with a Chinese company operating outside of the U.S. as a result of U.S. sanctions on the Chinese firm, this could, in China's opinion, constitute the unjustified extra-territorial application of a foreign law.

The new Measures, therefore, do little to redress the direct effect of U.S. sanctions on Chinese companies operating in the U.S. – because any companies that cut ties with Chinese companies operating on U.S. soil are merely complying with U.S. law. It is more likely that these Measures are intended as part of Beijing's wider effort to equip itself for trade disputes with countries or regions such as Australia, Canada and the EU.

Because the Measures are so fresh, and were not open to public consultation, there is a lot of uncertainty surrounding how they will be applied. However, MOFCOM has published the text of the legislation in both Chinese and English, as well as the transcript of a question & answer session held with Professor Han Liyu, a law professor at Renmin University, to aid understanding.<sup>3</sup>

The main factors that China will consider when determining whether a foreign law has been unjustifiably applied against one of its companies or citizens in a third market are:

- Whether international law or the basic principles of international violations are violated;
- Potential impact on China's national sovereignty, security and development interests;
- Potential impact on the legitimate rights and interests of Chinese parties; and
- Other relevant factors

### How will China use these Measures?

Should China decide that a foreign law or measure is being unjustifiably applied extra-territorially against one of its companies or citizens – be that in China itself or in a third market – MOFCOM will investigate and issue a 'Prohibition Notice' in retaliation.

A Prohibition Notice is a legal document ordering the company or citizen – be it Chinese or foreign – to refuse to recognise, execute, and/or comply with the foreign law that MOFCOM takes issue with.

For example, were a British company to receive a Prohibition Notice from MOFCOM stating that the ministry took issue with them cutting ties with a Chinese partner, they would be legally mandated to comply in accordance with Chinese law.

After a Prohibition Notice has been issued, two mechanisms are opened up for Chinese parties to seek judicial remedies through China's court system:

- Recovery of damages: If MOFCOM issues a Prohibition Notice against a foreign company or citizen that it deems to be complying with legislation that falls foul of the Measures – and causes harm to a Chinese party – the injured Chinese party can sue for compensation before PRC courts.
- Compensation for losses arising from foreign court decisions: If a company or citizen benefits from a judgement or ruling based on a foreign law or measure that MOFCOM has issued a Prohibition Order against, and this judgement results in a Chinese party incurring losses, the injured Chinese party can claim for compensation from PRC courts against the party who benefitted from the foreign judgement or ruling – regardless of whether the benefitting party is Chinese or foreign.

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<sup>3</sup>Text of Q&A [Chinese] <http://www.mofcom.gov.cn/article/news/202101/20210103029706.shtml>.

### What is the basis for these Measures? Can they be applied?

The new Measures are based in large part on similar European laws, but lack clarity in crucial areas. It's not clear, for example, how injured Chinese parties can bring claims of damages to court, or the extent to which Chinese courts can exert jurisdiction over foreign parties.<sup>4</sup>

Much of the text closely mirrors EU legislation, including clauses stipulating that:

- Chinese companies and citizens are obliged to report what they consider to be unjustified extra-territorial applications of foreign law to MOFCOM;
- that these reports will be kept confidential, so that the Chinese company doesn't face further repercussions from the sanctioning country;
- that any remedies will be applied via the court systems of, in this case, China;
- that Beijing reserves the right to issue a waiver after a Prohibition Notice has been applied, allowing the company to comply with the foreign law that MOFCOM considers to have been applied unjustifiably.

The Chinese text, like that of the EU, sets out the punishments those that do not adhere to the issuance of a Prohibition Notice can expect to receive.

A key area where Brussels' and Beijing's rules differ is that the EU's regulation includes an appendix clearly listing the markets where EU companies should not adhere to the extra-territorial application of foreign laws that the EU considers to be unjustifiable. China's regulations do not contain such text, which presents more uncertainty with regard to where and how the Measures might be applied.

The Measures will be applied by MOFCOM, which will establish a 'Working Mechanism' consisting of MOFCOM and various other central-government authorities, including the National Development & Reform Commission (NDRC), who will collectively take charge of implementation.

The NDRC's role is noteworthy, as it is also responsible for administering China's national security review regime. How the Measures and China's other TDIs will be used remains to be seen. In the case of the new Measures, it is questionable whether they will even be used at all: Similar legislation adopted by other markets has often been threatened but never implemented.

### Are Chinese companies obliged to report instances where they've been subjected to foreign laws or measures restricting their normal economic activities?

"A Chinese party caught in a position where a foreign law or measure prohibits or restricts its normal economic, trade and related activities with a third state or region or its citizens, legal persons or other organisations has an obligation to report this to MOFCOM within 30 days," according to CBBC member, Freshfields Bruckhaus Deringer.<sup>5</sup>

UK companies should note that while the legislation does not expressly require foreign companies to report to MOFCOM, the Chinese subsidiaries of multinational corporations may be considered to be a Chinese party and obliged to report all the same.

Failure to comply with these reporting obligations or a Prohibition Notice will result in a warning, an order from MOFCOM to rectify the matter within a specified time period, and/or a fine.

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<sup>4</sup> Text of the EU Regulation No. 2271/96: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31996R2271>.

<sup>5</sup> [http://knowledge.freshfields.com/en/Global/r/4321/china\\_promulgates\\_its\\_blocking\\_mechanism\\_the](http://knowledge.freshfields.com/en/Global/r/4321/china_promulgates_its_blocking_mechanism_the).

### Is there any way of getting around reporting?

From initial reading, it appears not. However, once MOFCOM has issued a Prohibition Order, companies may seek an exemption by writing to MOFCOM stating their reasons for one. However, the text of the Measures does not expressly give foreign businesses the right to apply to MOFCOM for an exemption, so whether this option will be conferred to foreign businesses remains to be seen.

### How might the Measure affect British companies operating in China?

British companies may be summoned to China's courts if they are found to be in breach of the Measures. I.e., If a British company severed ties with a Chinese partner, while operating outside of the U.S. to avoid falling foul of U.S. sanctions, they may be issued with a Prohibition Notice and, potentially, a court date in China.

However, UK companies should note that the Measures do not expressly grant MOFCOM or any other of the ministries involved in the Working Mechanism the authority to impose penalties on foreign businesses. The issue is likely to remain a potential compliance burden for UK companies operating in China regardless.

### CBBC View

The CBBC will continue to monitor how the Measures are implemented, and liaise with its members to better understand how the rules might be applied in practice.

The Measures could create an additional compliance burden for UK companies in China. However, whether the Measures are ever used remains to be seen. There is a good chance that they have been introduced mainly as a deterrent, as is the case for similar legislation in other markets.

At the very least, UK companies should be mindful of the fact that China does now have this piece of legislation on its books, and that it could be used to force British companies operating in China to choose between serving China or other markets. 

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