Overview

The Chinese government has enacted new "blocking" rules to counteract extraterritorial application of certain foreign laws that it deems unjustifiable. On January 9, 2021, China's Ministry of Commerce (MOFCOM) issued its No. 1 order of 2021—the Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures (the Blocking Rules). They were effective immediately.

The Blocking Rules set forth a framework for the Chinese government to counteract foreign laws, such as US economic sanctions and possibly export control laws or other laws, being applied extraterritorially in a way that affects China and are determined by China to be unjustifiable. The Blocking Rules are modeled on the EU blocking regime, but with differences and numerous important issues to be clarified by Chinese authorities as the framework is implemented.

To date, no such foreign laws have been identified. While the impact of the Blocking Rules is not yet certain, it is likely that companies operating in China or in third countries and also seeking to comply with US economic sanctions and export controls will need to consider whether and how the Blocking Rules will affect them, and to think through compliance strategies. This client alert outlines key aspects of the Blocking rules, including their scope and how they may work, and suggestions on compliance strategies to address these risks.

What You Need to Know About the Blocking Rules

Scope of Application

The Blocking Rules are designed to provide MOFCOM and other Chinese authorities with more discretion and flexibility in determining what laws they intend to block. The Blocking Rules apply to "foreign laws and measures" that (a) prohibit or restrict a Chinese citizen or entity's activities with a third country/region citizen or entity, (b) are deemed by Chinese authorities to be "unjustifiable," and (c) are in violation of "international law and the basic principles of international relations."

The Blocking Rules do not yet specify the foreign laws that are targeted. Unlike the EU Blocking Statute, there is no published annex of such laws, so companies will need to wait for such foreign laws to be specified by MOFCOM through prohibition orders.
It is anticipated that the Blocking Rules will most likely target so-called "secondary sanctions" in the area of economic sanctions, i.e., trade sanctions that impact third countries, or persons that are blacklisted regardless of location, but not measures that directly restrict trade between China and the sanctioning country, i.e., primary sanctions. This reading is based on a comment released by MOFCOM that included a reference to "secondary sanctions"—which would be consistent with the stated scope of application regarding foreign laws and measures that prohibit or restrict a Chinese citizen or entity’s activities with a third country/regional citizen or entity (as described above).

The US is not mentioned in the Blocking Rules or official commentary. Notwithstanding this observation, the US’s enactment of secondary sanctions where there is no apparent US jurisdictional nexus to offshore conduct is likely the impetus for the Blocking Rules, particularly the designation of foreign persons whose property is blocked under US sanctions, as well as possibly some of the more aggressive US export control restrictions. However, the Blocking Rules should not impact direct export and business restrictions on trade between the US persons and China. [1] Thus, US companies may continue to comply with primary US sanctions and export controls against China or involving targeted Chinese persons, but companies operating in China or in third countries will need to consider how compliance with US sanctions and export controls against China may implicate the Blocking Rules.

How the Blocking Rules May Work

MOFCOM, the National Development and Reform Commission (NDRC), and other relevant Chinese authorities (the Working Mechanism) are to assess whether the extraterritorial application of a reported foreign law or measure is unjustified. Such a finding would appear to also require the Working Mechanism's assessment of (a) whether the foreign law or measure violates an international law or a basic principle governing international relationships; (b) the impact on China's sovereignty, national security, and "development interest;" and (c) the impact on the legal rights and interests of Chinese persons, as well as any other factors that the Working Mechanism deems relevant.

The procedural requirements of the Blocking Rules include a reporting obligation for Chinese persons. Chinese citizens or entities (including, it would appear, Chinese subsidiaries and affiliates of foreign companies) experiencing a restricted trade or business transaction with a third country person as a result of a foreign law or measure must report such circumstances to MOFCOM within 30 days of the restricted impact. After receiving such a report, the Working Mechanism will assess whether the reported restriction constitutes unjustified extraterritorial application of foreign law. If the assessment is positive, MOFCOM will issue an order prohibiting the recognition of, compliance with, and enforcement of the foreign law or measure at issue. Once the order is issued, any affected person is required to comply with it and not to comply with the blocked foreign law or measure, unless an exemption has been obtained from MOFCOM. Only Chinese citizens or entities are allowed to apply for an exemption by submitting a written application to MOFCOM, setting forth the reasons for the application and for what activities or transactions the exemption is needed. The application will take up to 30 days from the date the application is accepted.

Unless an exemption applies, issuance of a prohibition order triggers the ability of an adversely-affected Chinese citizen/entity to sue for damages against the person who does not comply with the prohibition order. Additionally, the Blocking Rules state that Chinese authorities can provide (undefined) "necessary support" to Chinese citizens and entities that have suffered significant losses from complying with the prohibition order and not complying with the extraterritorial application of foreign laws or measures. In addition, the Chinese government can take necessary countermeasures against the extraterritorial foreign laws or measures.

Who Will Have to Comply with MOFCOM's Prohibition Orders

The Blocking Rules are clear that Chinese citizens and companies (including Chinese subsidiaries and affiliates of foreign companies) will have to comply with MOFCOM's prohibition orders. Violation of a prohibition order by "a Chinese citizen, legal person or organization" is subject to administrative penalties, including warning, correction order, and a fine to be specified. In addition, they may be sued by an adversely-affected Chinese citizen/entity for damages in a Chinese court.

In addition, the Blocking Rules appear to suggest that third country individuals and entities may also be sued by an adversely-affected Chinese citizen/entity for damages in a Chinese court. Specifically, the Blocking Rules state that "a person" (in contrast to "a Chinese citizen, legal person or organization") may be sued for damages in a Chinese court by a Chinese citizen or entity that has suffered damages from the person's compliance with a foreign law or measure that has been blocked by a prohibition order. In addition, the Blocking Rules allow "a person" benefitting from a judgment or ruling that is made based on a blocked foreign law or measure to be sued by a Chinese citizen or entity in a Chinese court if such a judgment or ruling has caused damages to a Chinese citizen or entity. But we note that it is not yet clear whether "a person" is intentionally different from "a Chinese citizen, legal person or organization" and covers "any" person, including third country persons.[2]

What You Can Do as Part of Your Compliance Strategies

Despite the need for further specification and clarity, there are steps that potentially affected parties may consider as part of their compliance strategies.
First, with respect to compliance with US sanctions, export, or other “extraterritorial” applications of laws, companies may evaluate whether they have over-complied or unnecessarily “de-risked” in light of the precise terms and reach of such US laws. Given the complexities of US economic sanctions and export controls, and the amount of civil and criminal penalties that have been imposed for violations or knowing conduct that allegedly contravened such laws, de-risking might be the appropriate approach to comply with US laws. However, this approach may need to be re-assessed in the context of business activity in China as it may cause new liabilities if the Chinese blocking regime is potentially applicable.

Second, with respect to commercial dealings that involve both the US and China, companies can evaluate if there are actions they can take to reduce the risk of being caught in a conflict of laws. Depending on the specific circumstances, those actions may include engagement with both US and/or Chinese government authorities. Preparation and implementation of proper internal guidance is key. Additionally, companies should establish focused internal mechanisms to monitor the actions of the Chinese government in what is likely to be a dynamic and discretionary implementation of the Blocking Rules.

Third, with respect to mitigating potential legal and business risks, companies can re-examine their contractual clauses (or terms and conditions in non-contractual business forms) as well as compliance policies that have been adopted in connection with US sanctions, export controls, or other laws that may have an extraterritorial element to them. This examination should include an assessment as to whether the clauses create potential liability under the new Blocking Rules, and whether modifications would be warranted. These contractual clauses are often in the form of representations and warranties, indemnification, governing law and venue, force majeure, dispute resolution, and possibly other relevant clauses. Compliance policies or procedures that may dictate the utilization of such safeguards may need to be reviewed, with a view to maintaining the appropriate protections against US legal liability while managing the downside risk of the Chinese Blocking Rules.

[1] It should also be noted that China has enacted a new national export control law that has elements similar to the US export control regimes. It is therefore unlikely that China would apply its Blocking Rules to US export controls where China has adopted similar restrictions for its own export control regime.

[2] In any event, as a potential consequence of a prohibition order, a judgment/ruling that is made based on a blocked foreign law or measure, presumably made outside of mainland China, is unlikely to be recognized/enforced in China because it is likely to be found to be “contradicting the basic principles of Chinese law or violating China’s sovereignty, national security or public interest” and therefore not meeting the statutory requirement for recognizing or enforcing a foreign judgment/ruling.