

Legal Commentary

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Analysis of China's "Blocking Statute"

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On January 9, 2021, with the approval of the State Council of China, the Ministry of Commerce ("MOFCOM") issued in its first decree of 2021 the *Rules on Counteracting Unjustified Extra-Territorial Application of Foreign Legislation and Other Measures* (the "Rules"), which took immediate effect¹. On January 10, the head of the MOFCOM Department of Treaties and Laws answered questions from reporters (the "Briefing") on issues related to the Rules². The promulgation of the Rules is in line with the prevailing practices worldwide when confronting unjustified extra-territorial application of foreign legislation and other measures. The Rules demonstrate China's wisdom and determination to protect the legitimate rights and interests of its citizens, legal persons and other organizations. In this article, we illustrate the provisions of the Rules, analyze future implementation scenarios by combining international practices, and finally conclude by sharing our thoughts.

Regulatory intent: to safeguard national interests and maintain normal economic and trade order

Article 1 of the Rules specify their regulatory intent, i.e., to block the impact of unjustified extraterritorial application of foreign legislation and other measures in China, safeguard national sovereignty, national security and development interests, and protect the legitimate rights and interests of citizens, legal persons, and other organizations of China. Formulation of the Rules is consistent with international practice. Since the middle of the 20th century, enacting blocking laws to address extraterritorial jurisdiction problem has been a growing trend worldwide. The European Union, Canada, Australia and many other countries have successively introduced their own blocking laws to prohibit the unjustified application of certain foreign laws which have extraterritorial effects in their territories. These laws cover many areas, ranging from securities, anti-monopoly, foreign economic sanctions to restrictive trade measures. For example, the European Union legislated its *Regulation on protecting against the effects of extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom* (Council Regulation (EC) No 2271/96, "EU Blocking Statute"), Australia passed its *Foreign Proceedings*

¹ <http://www.mofcom.gov.cn/article/zwgk/zcfb/202101/20210103029710.shtml>.

² <http://www.mofcom.gov.cn/article/news/202101/20210103029779.shtml>.

(*Prohibition of Certain Evidence*) Act, Japan implemented *Special Measures Law concerning the obligations to return profits gained in connection with the 1916 Act* and France published *Law No. 68-678, relating to the transfer of documents and information of an economic, commercial, industrial, financial or technical nature to foreign natural or legal persons*³.

Applicable scenarios: “citizens, legal persons or other organizations of China” facing unjustified extra-territorial application of foreign legislation and other measures

A prerequisite in applying the Rules is the existence of an extraterritorial action, according to Article 2. Specifically, the Rules apply to “situations where the extra-territorial application of foreign legislation and other measures, in violation of international law and basic principles of international relations, unjustifiably prohibits or restricts the citizens, legal persons or other organizations of China from engaging in normal economic, trade and related activities with a third State (or region) or its citizens, legal persons or other organizations.” Such “*citizens, legal persons, or other organizations of China*” includes all subsidiaries, offices, and representative offices of multinational companies that are domiciled in China. It should be noted that the Rules do not explicitly limit the obligations of prohibition orders only to Chinese entities. That being said, we do not rule out the possibility that such application may be expanded to relevant foreign entities via extensive interpretation.

According to Article 2 of the Rules, unjustified extra-territorial application of foreign legislation and other measures refers to laws and measures that “*prohibit or restrict the citizens, legal persons or other organizations of China from engaging in normal economic, trade and related activities with a third State (or region) or its citizens, legal persons or other organizations.*” Therefore, the implementation of the Rules is mainly for combatting the so-called secondary sanctions, that is, prohibiting or restricting normal economic and trade activities between domestic parties and those of third countries by virtue of an unjustified application of extra-territorial foreign legislation and other measures. Han Liyu, a professor from Renmin University of China Law School, expressed similar views in an interview⁴. It should be pointed out that the Rules adopt an open legislative approach, i.e., first an assessment by the Working Mechanism (as defined below) and then issuance of a prohibition order, which enables the related Working Mechanism office to have flexibility in conducting law enforcement. In other words, the Rules could be interpreted in an extensive manner to counter unjustified extra-territorial application of foreign legislation and other measures.

Reporting obligations, compliance obligations and relief measures

Article 4 of the Rules provides the operating mechanism. The State will establish a working mechanism composed of relevant central departments (the “**Working Mechanism**”), to be responsible for counteracting unjustified extra-territorial application of foreign legislation and other measures. In particular, the Working Mechanism is to be led by MOFCOM in coordination with the National Development and Reform Commission and other relevant departments. Notably, the Working Mechanism arrangement is similar to that of the “Unreliable Entity List”, which is also under the governance of the competent

³ Ye Yan, *On the EU Blocking Statute*, 2020 *Pacific Journal* 3, 50-66.

⁴ <http://www.mofcom.gov.cn/article/news/202101/20210103029706.shtml>.

department of commerce of the State Council. It is thus possible that these two mechanisms will be merged into one.

I Reporting obligations, compliance obligations and punishment

The Rules explicitly provide that *“where a citizen, legal person or other organization of China is prohibited or restricted by foreign legislation and other measures from engaging in normal economic, trade and related activities with a third State (or region) or its citizens, legal persons or other organizations, he/it shall truthfully report such matters to **the competent department of commerce of the State Council within 30 days.**”*

When the Working Mechanism, upon assessment, confirms an unjustified extra-territorial application of foreign legislation and other measures, the competent department of commerce of the State Council will issue a prohibition order, which requires the relevant foreign legislation and other measures not to be accepted, executed, or observed.

To ensure compliance with the reporting and compliance obligations, the Rules further provide corresponding penalty measures. Pursuant to Article 13 of the Rules, the competent department of commerce of the State Council may give a warning, order the Chinese party to rectify within a specified period of time, and may concurrently impose a fine according to the severity of the circumstances.

II Judicial remedies and State support

In addition to administrative penalties, non-compliance with a prohibition order may also trigger the risk of civil damage claims in China. According to Article 9 of the Rules, Chinese citizens, legal persons, or other organizations may initiate legal proceedings and claim for damages where they suffer losses due to an unjustified extraterritorial application of foreign legislation and other measures.

Specifically, with respect to the foreign legislation and other measures within the scope of a prohibition order, a Chinese party that losses suffers losses may claim for damages through legal proceedings against (1) a party who violates the prohibition order by observing and executing the foreign legislation and other measures within its scope, thereby infringing upon the Chinese party’s legitimate rights and interests; and (2) a party who benefits, to the Chinese party’s detriment, from a judgment or ruling made in accordance with the foreign legislation and other measures within the scope of the prohibition order.

Furthermore, according to Article 11 of the Rules, where a Chinese party 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, which provides further guarantees for the implementation of the Rules. Though the Rules and the Briefing do not specify the exact nature of such support, it may, according to the rulemaking background, include policies, industries, channels and financial advantages that would offset the losses suffered by these parties and weaken the substantial impact of foreign economic sanctions against China.

III Applications for exemptions to prohibition orders

Similar to the EU Blocking Statute, the Rules stipulate an exemption mechanism for parties frustrated

from practically complying with a prohibition order. Thus, upon issuance of a prohibition order, Chinese parties subject to it may apply for an exemption to the competent department of commerce of the State Council. Decisions on whether to approve the application will be made within 30 days from the date of acceptance of the application and may be made sooner under exigent circumstances.

Notably, exemptions are available under the Rules only to citizens, legal persons or other organizations of China, not to foreign parties.

Implementation scenarios

In the global context of unilateralism and “decoupling”, unjustified application of foreign laws and other measures has negatively affected the normal economic and trade activities of Chinese parties. In response, China has promulgated the Rules, which focus on prohibiting Chinese parties from complying with measures issued by foreign competent authorities that have extra-territorial effects and which unjustifiably affect the sovereignty and interests of China, preventing Chinese authorities from recognizing or implementing such measures, and providing affected Chinese parties with means to claim and seek redress.

In practice, the Rules may apply in scenarios where the U.S. export control system imposes extra-territorial restrictions on certain Chinese entities and/or its third-country trading partners. Such as trade restrictions under the List of Specially Designated Nationals and Blocked Persons (the “**SDN List**”) and the U.S. Entity List. Trade restrictions under Export Administration Regulations may also be included, which target products involving U.S. controlled items during the re-export and in-country transfer processing by applying the direct product rule or *de minimis* rule. If the application of the aforementioned U.S. export control system affects normal economic and trade activities between Chinese parties and those of a third country (or region), such application may be deemed to fall within the scope of Article 2 of the Rules, and thus trigger the blocking mechanism.

Potential issues

As China’s first blocking regulation, the Rules establish a system for China to respond to threats posed by foreign laws and regulations based on “long-arm jurisdiction”, reflecting China’s protection of judicial sovereignty and the legitimate interests of Chinese parties. However, due to the overarching nature of the Rules, detailed operating rules remain to be specified in future supporting provisions and guidelines. In the absence of specific guidelines and examples, enterprises may face practical problems requiring observation and answers during implementation.

I **Criteria and frequency of issuing prohibition orders based on the assessment of the Working Mechanism**

Instead of specifying assessment criteria, the Rules merely summarize in Article 6 several factors for the Working Mechanism to consider when assessing whether an application of law or other measure is unjustified. In addition, unlike the EU Blocking Statute, the Rules contain no similar annex that lists the exact scope of “foreign laws and other measures”. As a result, the competent authorities may determine on a case-by-case basis the criteria for issuing prohibition orders. As the MOFCOM

spokesperson stated in the Briefing, in practice, the Working Mechanism will focus on the specific circumstances of each case, comprehensively consider the factors listed in Article 6 of the Rules, and prudently carry out the assessment and determination in accordance with law.

During the Briefing, the MOFCOM spokesperson did not clearly indicate how frequently prohibition orders would be issued. In light of the experience of other countries, blocking statutes serve more as a symbolic, rather than practical, piece of legislation. For example, since the EU Blocking Statute came into effect, it has only attempted to be preliminarily implemented twice, but has never been actually implemented⁵. Given the above, the implementation and frequency of the enforcement of the Rules remains to be further observed in practice.

II Performance of reporting obligations

Article 5 of the Rules stipulates that Chinese parties are required to truthfully report within 30 days the unjustified extra-territorial application of foreign legislation and other measures. The failure to truthfully do so may result in warnings or penalties. Considering that the Rules adopt an open approach based on assessments and no prohibition orders have yet been issued, relevant parties will face the problem of a scarcity of guidance when judging whether a prohibition or restriction on trade and other relations constitutes an unjustified extra-territorial application under the Rules. Overall assessments and judgments are thus required. As for multinationals, relevant assessments and judgments may involve many factors and processes. Uncertainty exists as to whether all parties will be able to fulfill the reporting obligation within the stipulated period. In practice, it remains to be further clarified how the relevant authorities will guide affected parties in the internal evaluation and judgment process, and how the authorities will determine whether the enterprise has timely fulfilled its reporting obligations.

III Conflict of Laws

Considering that the Rules inherently give rise to conflicts of laws, their application will undoubtedly conflict with foreign laws. Hence, relevant parties will often be caught in a dilemma, especially in the case of multinationals. As an analogy, in recent anti-monopoly litigation on the global royalty rates of standard-essential patents (“SEP”), occasions repeatedly occur where courts in different jurisdictions separately issue anti-suit injunction orders and anti-anti suit injunction orders for the determination of the same rates⁶. Thus, how to simultaneously comply with the rulings made by the courts of different jurisdictions but which are in substantial conflict is a real predicament faced by the parties.

As a solution, the Rules establish a mechanism for Chinese parties to be exempted from complying with prohibition orders. However, the exemption mechanism does not apply to foreign entities operating in China. This circumstance could present challenges for such parties.

Compliance advice

I Chinese enterprises should strengthen their internal assessment measures and promptly

⁵ Ye Yan, On the EU Blocking Statute, 2020 Pacific Journal 3, p. 50-66.

⁶ https://www.sohu.com/a/426244010_166680.

report prohibitions or restrictions on economic, trade or other relations caused by extra-territorial foreign legislations or measures. Enterprises should monitor for prohibition orders and also apply for exemptions in a timely manner

If a Chinese enterprise encounters a prohibition or restriction on trade involving a third country or region that may result from foreign legislation or other measures such as the U.S. Export Control System, the enterprise should first conduct an internal assessment in accordance with Article 6 of the Rules and determine whether its application may be unjustified. If so, the Chinese entities should report to the relevant authorities in a timely manner within the stipulated 30-day period.

In addition, Chinese enterprises should actively monitor the issuance of prohibition orders in their respective industries. If a Chinese enterprise has special difficulties or circumstances in practically complying with a prohibition order, the enterprise may submit a written application for an exemption from the prohibition order to the Ministry of Commerce, which includes the reasons and scope of the exemption.

II For multinationals, the promulgation of the Rules does not necessarily mean that they will have to continue to cooperate with Chinese enterprises and institutions on the U.S. Entity List

As to the spotlighted U.S. Entity List issue, the promulgation of the Rules does not necessarily mean that multinational companies will have to immediately continue to cooperate with Chinese enterprises and institutions on the U.S. Entity List.

On the one hand, currently, the Rules present only framework provisions. It remains to be seen whether the U.S. Entity List would constitute an unjustified extra-territorial application of law. Even after being confirmed, relevant enterprises could still proactively seek exemptions through their Chinese affiliates to protect their interests.

On the other hand, in accordance with the Briefing, the Rules aim to block unjustified extra-territorial applications that prohibit or restrict normal economic and trade activities between Chinese parties and those of third countries, so as to maintain a normal business environment. Thus, if an enterprise intends to continue a transaction, the Rules can help to ensure the transaction proceeds unhindered by unjustified extra-territorial applications of law. However, where a party chooses to terminate a transaction, the Rules fail to provide clear guidance for distinguishing between normal commercial decision-making as opposed to compliance with the unjustified extra-territorial application of foreign law. In this respect, it is doubtful whether the Rules could practically require multinationals to continue to cooperate with Chinese companies and institutions on the U.S. Entity List.

Conclusion and prospects

The Rules provide several groundbreaking mechanisms and introduce measures such as judicial remedies, which ensure the protection of legitimate trade activities between Chinese entities and transaction counterparties in third countries. However, several practical issues such as the scope of foreign legislation and other measures, the specific implementation scenarios, and the manner in which the Rules may coordinate with judicial authorities remain to be explained by future ancillary rules, guidelines, and practical observations.

Important Announcement

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