

# KEY TAKEAWAYS AND Q&AS TO UNDERSTAND CHINA'S EFFORT TO ESTABLISH ITS OWN LEGAL REGIME OF EXTRATERRITORIAL JURISDICTION

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## China Policy and Regulatory Alert

By: Amigo L. Xie, Steven F. Hill

On 10 June 2021, the Standing Committee of the National People's Congress reviewed and approved the Anti-Foreign Sanctions Law (the AFSL), which took effect on the same day. The AFSL was enacted within two months and without an opportunity for public comment.

The AFSL gives the Chinese government authority to prohibit compliance by Chinese persons, including entities in China, with certain foreign sanctions laws and export control restrictions that are deemed to have a discriminatory impact on Chinese citizens or organizations. It offers governmental authorities a high degree of implementation flexibility according to specific circumstances and needs. The AFSL introduces new risk factors for the business community, which already faces challenges in balancing compliance requirements under conflicting bodies of law. This alert highlights key takeaways and answers some key questions arising from the new law. Some of these questions may be clarified in implementation rules and measures that authorities are expected to issue in the near future.

## KEY TAKEAWAYS

Many global businesses have developed useful tools and solutions to comply with applicable sanctions measures, most notably U.S. and EU sanctions, such as regular screening of customers against sanctions lists, screening of transactions for connection with embargoed countries, and compliance covenants for customers. Additionally, in some cases, companies have had to navigate treacherous waters between competing sanctions regimes where compliance with one set of laws could mean violation of another. This has especially been the case with the EU “blocking” measures that prohibit EU persons' compliance with certain U.S. embargo measures.

With adoption of the AFSL, organizations and individuals in China and elsewhere must now focus not only on compliance with the U.S. and EU sanctions, but also on countermeasures under Chinese laws. This presents a significant challenge in developing a plan to ensure compliance with applicable sanctions regimes while not running afoul of Chinese laws.

Given the lack of specificity in the AFSL, how the law will function in practice is an open question. If strictly enforced, businesses in China, including multinational companies and their Chinese subsidiaries, may face a significant dilemma complying with potentially contradictory laws imposed by China and other foreign sanctions and export control measures to which they are also subject. If resolution of this conflict is not possible, companies may have to choose which regulator and enforcement authority presents a bigger threat. This could have a

significant impact on how multinational companies with operations in China shape their compliance policies and procedures.

In response to this dilemma, companies may consider implementing diligence measures to screen parties before entering into or termination of a business relationship, such as (i) a more detailed background check on potential customers to assess sanction-related risks before establishing business relationships, or (ii) the collection of information about the background and reasons for sanctions against an existing contracting party and determination of whether any discriminatory restrictive measure is involved before the termination of the relevant business relationship. However, it is worth noting that merely refusing to do business because of application of U.S. or other foreign sanctions could itself be deemed a violation under the AFSL. This is also how the EU and Canadian blocking statutes operate.

While Chinese authorities have not yet issued guidance on what measures could be deemed discriminatory and thereby trigger application of the AFSL, a recent opinion by the EU Advocate General in connection with a court claim filed by Bank Melli of Iran concerning the Deutsche Telekom's termination of a contract in compliance with U.S. primary sanctions on Iran may hint at how the AFSL will be enforced.<sup>1</sup> The EU Advocate General specifically said that an EU company seeking to terminate an otherwise valid contract with an Iranian entity subject to U.S. sanctions must satisfactorily demonstrate that it did so for reasons other than compliance with U.S. measures. If this approach is taken, it may be possible to justify actions that appear to be in compliance with U.S. and EU sanctions by pointing to other valid reasons for taking such actions.

Whether this approach would be accepted by Chinese courts remains to be seen. In any event, considering the key word “discriminatory” in the AFSL, it could be helpful if a terminating party can demonstrate that it is acting pursuant to established internal procedures unrelated to compliance with U.S. or EU sanctions.

In addition to the foregoing precautions, businesses should consider the following further compliance measures:

- Revising current contract templates to mitigate the risk that the provisions in a contract violate the AFSL directly. For example, it is common to include a provision in contracts allowing a party to terminate the contract in the event that the other party is included on a U.S. sanctions list. As we mentioned above, termination of an otherwise valid contract with a Chinese entity for the purpose of compliance with U.S. sanctions could be subject to a lawsuit in China under the AFSL.
- Consider a two-way rather than a one-way (i.e., the United States and the European Union only) screening of potential or existing customers/suppliers against non-Chinese sanction lists and Chinese anti-sanction lists.
- Develop internal guidelines to explain and justify that commercial decisions are not undertaken in compliance with foreign sanctions when refusing to conclude contracts with certain Chinese organizations or individuals, and demonstrate with coherent and systematic practice, among other things, that these commercial decisions do not violate the AFSL.
- In the event of the termination of a contract with a Chinese citizen or company, maintain records and evidence supporting the claim that the termination was unrelated to compliance with foreign discriminatory restrictive measures.

- Consider engagement with the relevant departments of the State Council if the company cannot implement countermeasures based on the particular facts of their business to mitigate risk of being held liable under Articles 11 and 14 of the AFSL.

To understand the AFSL further, below are our answers to four key questions about the new law.

## QUESTION 1: WHAT IS THE PURPOSE AND IMPLICATION OF THE LEGISLATION?

Prior to the enactment of the AFSL, there were a few provisions about countermeasures in other Chinese laws or administrative rules, such as Article 48 of the Export Control Law and the Regulation on Unreliable Entity List and Measures to Block the Improper Extraterritorial Application of Foreign Laws and Measures (Blocking Measures) introduced by the Ministry of Commerce of China (MOFCOM) in September 2020 and January 2021, respectively.

The AFSL provides a legal framework to further enhance China's countermeasure legal regime from the following perspectives:

- **Statute.** Different from MOFCOM, the Standing Committee of the National People's Congress exercises the legislative power in China. So, the AFSL has a higher legal status than administrative rules enacted by MOFCOM. Also, the AFSL can apply to more commercial areas than the Export Control Law does, which mainly focuses on international trade.
- **Authorization to Departments of State Council.** The Ministry of Foreign Affairs used both entry bans and trade bans in its sanctions against the United States, the European Union, the United Kingdom, and Canada in January and March of this year. Strictly speaking, however, there is no clear legal basis for such sanctions. Under the Legislative Law, countermeasures or administrative rules themselves could be a problem in the absence of the basis of laws. The AFSL provides that legal basis and authorizes the departments of State Council to take countermeasures by establishing counter-sanction lists, implementing travel ban and asset freeze measures and restricting transactions with listed individuals and organizations. This is one of the reasons why the AFSL was passed on an accelerated basis, according to the explanations offered by the director of the Legal Affairs Committee of the Standing Committee of the National People's Congress on 26 April 2021.<sup>2</sup>
- **Legal Basis of Future Rules.** The AFSL provides a catch-all clause (Article 13) that, in addition to the AFSL, relevant laws, administrative regulations, and departmental rules, may provide for the adoption of other necessary countermeasures against acts that endanger China's sovereignty, security, and development interests. This provides a legal foundation for further legislation and actions under the AFSL, enhancing the toolkit of measures that Chinese authorities may use. For this reason, the enactment of the AFSL is a stronger tool in China's legal toolkit, according to the director of the Legal Affairs Committee of the Standing Committee of the National People's Congress.<sup>3</sup>
- **Direct and Proactive Sanctions.** The AFSL primarily emphasizes countermeasures against foreign sanctions. However, Article 15 provides the legal basis for implementing proactive sanctions where any direct countermeasure or sanction is necessary against any foreign country, organization, or individual that implements, assists in, or supports any act endangering China's national sovereignty, security, or

development interests. This could result in sanctions being imposed on foreign entities or individuals not connected to foreign sanctions or discriminatory restrictive measures.

## **QUESTION 2: WHAT ARE COVERED FOREIGN SANCTIONS?**

Under Article 3, the main target of the AFSL is the application of unilateral foreign sanctions. In other words, the AFSL is targeting certain unilateral state actions rather than foreign sanctions imposed under international law. In fact, the Ministry of Foreign Affairs issues circulars from time to time to implement sanction lists according to resolutions of the United Nations Security Council.<sup>4</sup>

The AFSL authorizes the relevant departments of the State Council to include individuals and organizations that are directly or indirectly involved in the formulation, decision-making, or imposition of discriminatory restrictive measures as set forth in Article 3 of the AFSL in an anti-sanction list. The AFSL, however, does not define “discriminatory restrictive measures.”

Until the scope of “discriminatory restrictive measures” is better understood through actual application and implementation of the AFSL, the only clue we may look to in order to understand the scope of “discriminatory restrictive measures” against China is Article 3.

Article 3 provides for the following triggering event(s) of China’s countermeasures:

“Where a foreign country,

- violates international law and basic norms of international relations,
- contains or suppresses China on various pretexts or in accordance with its own laws,
- adopts discriminatory restrictive measures against any Chinese citizen or organization, and/or
- meddles in China's internal affairs.”

Literally speaking, if a sanction or restrictive measure of a foreign country does not focus on China specifically, it appears as if such a foreign sanction is not discriminatory. Thus, for example, an export control measure that applies equally to persons from all countries, such as a ban on the export and re-export of chemical weapons precursors, would not be deemed discriminatory if applied to a Chinese company that breaches the measure.

## **QUESTION 3: WHO ARE INDIVIDUALS AND ORGANIZATIONS COVERED?**

The AFSL prohibits the implementation of foreign discriminatory restrictive measures against Chinese citizens and organizations. For this purpose, persons covered by the AFSL are twofold:

- Persons subject to countermeasures under Articles 4 and 5 or lawsuits under Article 12.
- Persons who implement countermeasures under Articles 11 and 14.

Article 4 mainly targets foreign lawmakers, government officials, and organizations responsible for formulation, decision-making, and/or imposition of discriminatory restrictive measures and authorizes the relevant departments of the State Council to include those individuals and entities in an anti-sanction list. Article 5 extends the scope of persons who are subject to countermeasures to affiliates of persons who are included in the anti-sanction list.

For individuals and organizations who implement or assist in the implementation of foreign discriminatory restrictive measures against Chinese citizens or organizations, Article 12 enables Chinese citizens or organizations to initiate lawsuits in Chinese courts for injunctive relief and damages. Generally, the individuals and organizations involved are Chinese citizens' or organizations' suppliers, customers, or business partners who are in compliance with foreign sanctions.

Article 11 of the AFSL further requires individuals and organizations within Chinese territory to implement the countermeasures imposed under the AFSL, and Article 14 provides that any individual or organization that fails to implement or cooperate with the implementation of Chinese countermeasures will be held legally liable. In terms of the scope of persons who should implement Chinese countermeasures, the difference between Article 11 and Article 14 is subject to clarification.

The scope of persons covered by the AFSL is vague. For example, there is no definition of persons “indirectly involved in” formulation, decision-making, or imposition of discriminatory restrictive measures under Article 4. This could leave application of the provision open to a wide variety of organizations and individuals who cooperate in the formation or imposition of restrictive measures.

While it remains to be seen how the Chinese government will implement the law, the AFSL grants the departments of the State Council extensive discretion when they implement the AFSL in this regard. This could have a chilling effect on individuals and organizations, even including in-house or external counsel to multinationals in China when they advise on compliance with U.S. sanctions.

## **QUESTION 4: WHAT ARE THE REMEDIES TO PERSONS COVERED UNDER THE AFSL?**

As the head of the Legal Affairs Committee of the Standing Committee of the National People's Congress explained to reporters, Chinese countermeasures taken under Articles 4 to 6 are state sovereign actions.<sup>5</sup> As such, the relevant decisions made by departments of the State Council are final decisions. This is consistent with Article 13 of the Administrative Procedure Law, which provides that state actions involving national defense or diplomacy are not subject to judicial review.

Additionally, unlike the Blocking Measures, the AFSL does not provide for a mechanism to request an exemption application of the law.

In the event of an erroneous listing decision or countermeasure, the remedy under the AFSL will be to communicate with the relevant departments of the State Council and seek their consents to suspend, change, or cancel the relevant listing decision or countermeasures under Article 8 of the AFSL.

## **CONCLUSION**

There will be many additional important developments as Chinese authorities further clarify and, ultimately, implement provisions of the AFSL. The K&L Gates attorneys listed on this alert can assist you if you have any questions or concerns about this law or other legal developments.

## **FOOTNOTES**

- <sup>1</sup> See Opinion of Advocate General Hogan (May 12, 2021), <https://curia.europa.eu/juris/document/document.jsf?text=&docid=241168&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=6093084>
- <sup>2</sup> Note to the Anti-Foreign Sanctions Law of the People's Republic of China (Draft) (Apr. 26, 2021), <http://www.npc.gov.cn/npc/c30834/202106/99804919249244e593383c9da4e39ddf.shtml>
- <sup>3</sup> *Id.*
- <sup>4</sup> Notification of the Implementation of Security Council Resolutions, [https://www.fmprc.gov.cn/web/wjb\\_673085/zfxxgk\\_674865/gknrlb/jytz/](https://www.fmprc.gov.cn/web/wjb_673085/zfxxgk_674865/gknrlb/jytz/).
- <sup>5</sup> The Head of the Legal Affairs Committee of the Standing Committee of the National People's Congress Answers Reporters' Questions on the Anti-Foreign Sanctions Law, [http://www.xinhuanet.com/politics/2021-06/10/c\\_1127551967.htm](http://www.xinhuanet.com/politics/2021-06/10/c_1127551967.htm).

## KEY CONTACTS



**AMIGO L. XIE**  
PARTNER

HONG KONG  
+852.2230.3510  
AMIGO.XIE@KLGATES.COM



**STEVEN F. HILL**  
PARTNER

WASHINGTON DC  
+1.202.778.9384  
STEVEN.HILL@KLGATES.COM

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