



Business in China after the blocking statute



Blocking statutes invariably attract attention, but frequently, their potential remains unrealised! With China's MOFCOM having recently taken a leaf out of the EU book, Nick Klein, David Peyman and Nate Bolin of DLA Piper explore its possible consequences – and the measures businesses are using to reduce the risk of falling foul.

As economic sanctions have increasingly become the US foreign-policy tool of choice to achieve national security objectives and uphold American values, their targets, as well as US allies and trading partners caught in the middle, have attempted to shield themselves from the long reach of US extra-territorial laws by passing so-called 'blocking statutes'. This has created a tension between US sanctions and the laws of other jurisdictions that companies operating globally must navigate carefully, lest they be caught between the Scylla and Charybdis of conflicting legal regimes. China's recent passage of its own blocking statute has only added to the sanctions

compliance challenges facing global companies.¹

The tension between US sanctions and blocking statutes was brought into sharp focus by the Trump administration's withdrawal in 2018 from the Joint Comprehensive Plan of Action ('JCPOA'), also commonly referred to as the 'Iran nuclear deal', which was a multilateral agreement between Iran and the five permanent members of the UN Security Council – China, France, Russia, UK, US, along with Germany, and the EU represented by the Commission. The agreement provided certain sanctions relief to Iran in exchange for curtailments by Iran to its nuclear developments, which would be verified by

the International Atomic Energy Agency ('IAEA'). Partially in response to the US withdrawal from the JCPOA and along with the already existing conflict posed by the US sanctions on Cuba, the EU updated a 1996 blocking statute² to protect European companies from the application of US sanctions related to business activities in Cuba and Iran and to recover damages from counterparties that terminate business due to US sanctions. Essentially, the EU blocking statute seeks to minimise US extraterritorial reach regarding US sanctions on Cuba and Iran and help preserve the JCPOA without US participation.

In response to the EU's expansion of the blocking

statute to cover such US secondary sanctions on EU companies doing business in Iran, the Trump administration made clear that, blocking statute or not, EU companies that violated US secondary sanctions may be cut-off from the US economy and financial system.³ Choosing to do business between Iran and the US was not much of a choice, and many European governments were reluctant to enforce the EU blocking statute against their own companies. Nevertheless, many EU companies could not simply ignore an EU statute, even if unenforced, and were made to navigate very treacherous legal waters. Recently, however, the courts of EU nations and the EU itself have enforced the

blocking statute in regard to Iran. For example, the EU Court of Justice recently confirmed that the EU blocking statute provided a private cause of action to Bank Mellé against Telekom Deutschland for terminating a contract for services after Bank Mellé was sanctioned by the US in 2018.⁴ Indeed, the UK believed the blocking statute important enough to protect UK companies and limit US jurisdictional reach that on leaving the EU on 31 December 2020 the UK government retained the blocking statute in UK legislation.⁵ In further efforts to support the JCPOA and EU companies, the EU, led by France, Germany and at the time the UK, created a special purpose vehicle known as INSTEX,⁶ which would help companies mitigate US sanctions risks when operating and dealing with Iran. However, INSTEX has not been significantly used since it was established on 31 January 2019 partially due to the message from the Trump administration that



CHINA'S BLOCKING RULES RESPOND TO THE INCREASED USE OF THE 'SECONDARY' ECONOMIC SANCTIONS AND EXPORT CONTROLS BY THE US.

those utilising INSTEX would be investigated by the US and could be targeted under US sanctions.⁷

Given this background, when in late 2020 the Trump administration began to impose sanctions on China, for a number of reasons including China's actions in Hong Kong and persecutions of the Uighur population, it was not surprising that China would look to the example of the EU blocking statute in formulating its own version providing for government regulatory retaliation and private lawsuits for those that comply with

US sanctions at China's expense. On 9 January 2021, China's Ministry of Commerce ('MOFCOM') issued the Rules on Counteracting Unjustified Extra-Territorial Application of Foreign Legislation and Other Measures (the 'Blocking Rules'). The Blocking Rules seek to establish a regulatory framework to neutralise adverse effects on Chinese parties and national interests of foreign laws and governmental measures with extraterritorial effect (particularly measures disrupting commercial relationships with third-countries). They seek to do this primarily through 'prohibition orders' that nullify challenged foreign measures and – like the EU blocking statute – by creating a private right of action for injured Chinese parties to recover damages from counterparties that comply with 'prohibited' foreign measures.

China's Blocking Rules respond to the increased use of the 'secondary' economic sanctions and export controls by the US that seek to prevent parties in third countries dealing in US technology from continuing to do business with primary targets in China. The US Department of Commerce, for example, has imposed multiple export control restrictions on companies doing business with Huawei Technologies Co., Ltd. and most of its non-US affiliates.⁸ Most recently, these restrictions prohibited companies from supplying Huawei with a wide range of items produced overseas based on US technology or

US production equipment.

It remains to be seen how, if at all, China will enforce its new Blocking Rules. China's approach is likely to depend in part on the Biden administration's further actions to sanction companies in China. While it is still early days, it remains possible that the Biden administration will respond to China's Blocking Rules much the same way that prior US administrations have handled similar blocking statutes – i.e., by sending a clear message that anyone doing business in China in violation of US sanctions will not be permitted to do business with the US or use the US dollar or US technology.

Such a US response will pose a very difficult choice for global companies. China is a far more significant trading partner and target of global investment than Iran. Thus, forcing many global companies to choose between business with the US and the world's second-largest economy is likely to have far more serious consequences. Even if the Chinese do not enforce their retaliatory measures, many companies in China will be hard-pressed to simply ignore Chinese law as a matter of policy. Both China and the US are also dealing with economies that are only now beginning to exit a post-pandemic lockdown. These factors may force the US and China to moderate their approaches to sanctions and the Blocking Rules.

Private sector actors caught between these opposing forces can expect to face a complex regulatory environment in the months and years ahead. Having said that, sophisticated actors will devise effective strategies to abide by US sanctions while minimising the risk of Chinese reprisal. These strategies may require shifting supply chains to avoid the challenge of compliance with competing laws altogether but may also include sophisticated

Links and notes

- 1 Ministry of Commerce Order No. 1 of 2021 blocks the improper extraterritorial application of foreign laws and measures (mofcom.gov.cn)
- 2 Updated blocking statute in support of Iran nuclear deal enters into force (europa.eu)
- 3 <https://iclg.com/practice-areas/sanctions/4-key-aspects-of-u-s-financial-sanctions-risk-for-non-u-s-companies> ('importantly, OFAC will pursue such actions even when the jurisdiction in which the foreign company operates maintains blocking statutes that prohibit compliance with the US embargoes (e.g., Canada and the EU). Companies operating in such jurisdictions should be aware that the existence of such laws does not provide a defence to OFAC enforcement.')
- 4 Advocate General Hogan: Iranian undertakings may invoke EU law blocking US secondary sanctions before the courts of the Member States (europa.eu)
- 5 Protection of Trading Interests (retained blocking regulation) – GOV.UK (www.gov.uk)
- 6 Joint statement on the creation of INSTEX, the special purpose vehicle (publishing.service.gov.uk)
- 7 <https://www.voanews.com/middle-east/voa-news-iran/exclusive-us-vows-pursue-ship-owners-who-violate-iran-oil-sanctions>
- 8 Huawei Technologies Co., Ltd. and many of its non-US affiliates were initially listed on the Entity List in May 2019, restricting its access to items subject to the US Export Administration Regulations. BIS, Final Rule, Addition of Entities to the Entity List, 84 Fed. Reg. 22961 (16 May 2019). The US government has since expanded restrictions related to Huawei Technologies Co., Ltd. and its non-US affiliates.
- 9 Testimony on Economic Recovery by Janet Yellen, US Secretary of the Treasury, US Senate Finance Committee 16 June 2021.
- 10 https://www.fdd.org/wp-content/uploads/2020/03/Transcript_Peyman_Sanctions_March2020.pdf at page 9.



WHILE IT WOULD BE A MISTAKE TO ASSUME THAT CHINA'S NEW BLOCKING RULES WILL NEVER BE ENFORCED, IT IS ALSO A MISTAKE TO ASSUME THAT CHINESE COMPANIES AND POLICYMAKERS ARE NOT CAPABLE OF A NUANCED AND BALANCED APPROACH.

engagement with both the US and Chinese governments.

An important part of this strategy will include understanding the Biden administration's approach on China. The President has thus far articulated a policy that considers China a strategic *competitor* and not a strategic *enemy* and acknowledges the necessity of working with the private sector to invest in artificial intelligence, telecommunications, biosciences, and

infrastructure. This approach suggests that the US will continue to seek to work constructively with the private sector to bridge gaps in US-China foreign policy and avoid a total 'decoupling' of the two economies – as Treasury Secretary Yellen recently said in testimony before Congress.⁹

It is also important for companies doing business in or with China to recognise the position of China's leadership and the level of understanding – both with the Chinese government and private sector – of sometimes complex US sanctions. While it would be a mistake to assume that China's new Blocking Rules will never be enforced, it is also a mistake to assume that Chinese companies and policymakers are not capable of a nuanced and balanced approach to these challenging issues. Unlike the EU blocking statute, which addresses conflicting sanctions requirements on dealing with third countries (Iran and Cuba), the China Blocking Rules address the concern of US sanctions targeting China and Chinese companies directly. This dynamic is more likely to result in direct conflict and potential enforcement with significant implications to US-China relations and foreign policy. Developing a solid understanding of the position of China's leadership and enforcement agencies while seeking areas of common interest will be key to meeting these challenges.

Nate Bolin is a Partner and Nicholas Klein David Peyman are Of Counsel in DLA Piper's office in Washington, DC.

Nate Bolin advises on US trade remedies, export controls, economic sanctions, the Committee on Foreign Investment in the United States ('CFIUS') and related areas of national security and international trade laws. Due to his extensive experience with the International Traffic in Arms Regulations (ITAR), Nate has been appointed by the Assistant Secretary of State for Political-Military Affairs to serve on the US State Department's Defense Trade Advisory Group for three consecutive terms, most recently for the 2020-2022 session. He also advises companies on compliance with the Office of Foreign Assets Control ('OFAC') sanctions and US export control laws.

Nicholas Klein has significant experience advising clients on international trade and national security matters, including national security reviews before the CFIUS, US export controls, economic sanctions, anti-bribery and corruption, anti-money laundering, and mitigation of foreign ownership, control or influence under industrial security regulations.

David Peyman has extensive public and private sector experience in economic sanctions, AML, corporate compliance, and international trade. From 2018 to 2020, David served as the Deputy Assistant Secretary of State for Counter Threat Finance and Sanctions in the Bureau of Economic and Business Affairs. As the State Department's sanctions chief, David led the Office of Economic Sanctions Policy and Implementation.

www.dlapiper.com

Chinese state-owned enterprises and Beijing have proven capable of pursuing economic interests and working productively with the US government when faced with US sanctions,¹⁰ establishing precedent for productive engagement.

Ultimately, a sophisticated corporate strategy cannot simply view compliance as a mechanism to respond to the technicalities of laws and as a necessary cost of doing business. Rather, robust compliance efforts that take account of the

most important government national security concerns can be leveraged into creating added value, mitigating corporate risk, and avoiding unintended consequences. Companies should understand the policies driving US sanctions laws, assess their risks and devise strategies to leverage responsible compliance into obtaining concrete relief to continue, and even expand, business in jurisdictions like China that have pursued a blocking statute response to US sanctions. 📌

Reprinted with permission from the July-August 2021 Issue 2 of *FISC*, the sanctions compliance journal for financial institutions, their advisors and customers.

For subscription enquiries in order to receive issue 2 and future issues please email: FISC@worldcr.com