

# China Establishes Blocking Mechanism Aimed at Extraterritorial Foreign Laws

January 14, 2021

On January 9, 2021, the Ministry of Commerce of China (“MOFCOM”) released Order No. 1 of 2021 on Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures (“Measures”),<sup>1</sup> barring Chinese companies and individuals from complying with foreign laws and measures that prohibit or restrict commercial activities between Chinese parties and parties from third countries. The Measures took effect immediately on their release. The Measures are most likely to be used as a blocking mechanism against U.S. and other sanctions regimes and could have significant consequences for companies doing business in China or with Chinese counterparties. As with much Chinese legislation, the Measures are vague in places and their full impact cannot be assessed until further clarification is provided, either through additional guidance or enforcement actions.

The Measures are the latest in a series of actions by the Chinese government to counteract extraterritorial application of foreign laws, including the establishment of rules relating to an “unreliable entities list.”<sup>2</sup> The Measures are similar in form and substance to EC Regulation 2271/96, the EU blocking statute designed to combat U.S. sanctions against Cuba and Iran.<sup>3</sup> Like the EC Regulation, the Measures impose a reporting obligation on Chinese parties that are affected by extraterritorial application of foreign laws and provide a private right of action for those injured by such laws.

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<sup>1</sup> Official translation available at <http://english.mofcom.gov.cn/article/policyrelease/questions/202101/20210103029708.shtml>.

<sup>2</sup> See “China’s Ministry of Commerce Establishes Framework for Sanctions Against Unreliable Entities,” September 28, 2020, <https://www.debevoise.com/insights/publications/2020/09/chinas-ministry-of-commerce-establishes-framework>.

<sup>3</sup> Council Regulation (EC) No 2271/96 of 22 November 1996 (protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31996R2271>.

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## SCOPE OF THE MEASURES

The Measures apply to situations where the extraterritorial application of foreign laws or measures “unjustifiably” prohibits or restricts Chinese parties from engaging in commercial activities with parties from third countries or regions.<sup>4</sup> Excluded are extraterritorial restrictions on commerce established under international treaties and conventions in which China has entered (e.g., sanctions imposed by the United Nations).<sup>5</sup> Unjustifiable foreign laws could include sanctions, export restrictions and similar restraints imposed by other countries or blocs of countries.

As drafted, the Measures apply to Chinese individuals and companies, including the Chinese subsidiaries or affiliates of multi-national companies. By contrast, foreign subsidiaries of Chinese companies, if incorporated under local law, are usually deemed as non-Chinese entities, and thus are not likely to be subject to the Measures. Chinese citizens based abroad and Chinese entities operating in another country without separate incorporation (such as via branch offices) are considered Chinese parties and theoretically are governed by the Measures.

Unlike the EU blocking law, which addresses specific U.S. sanctions, the specific laws covered by the Measures are not identified. Instead, the Measures require Chinese companies and individuals that are subject to extraterritorial application of foreign laws that “unjustifiably” restricts commerce with third countries or regions to report such restrictions within thirty days. Then, a new “work mechanism” will be established to handle these reports and counteract the extraterritorial application of foreign laws. The “work mechanism” will be led by MOFCOM.

The “work mechanism” will evaluate reports and determine whether the extraterritorial application of foreign laws and measures is “unjustified,” based on the following considerations:

- whether international law or the basic principles of international relations are violated;
- potential impact on China's national sovereignty, security and development interests;
- potential impact on the legitimate rights and interests of the citizens, legal persons or other organizations of China; and

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<sup>4</sup> Art. 2 of the Measures.

<sup>5</sup> *Id.*, Art. 3.

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- “other factors that shall be taken into account.”<sup>6</sup>

If the “work mechanism” determines an extraterritorial application of foreign law or other measure is “unjustified,” it may determine whether a “prohibition order” may be issued by the MOFCOM. Once a prohibition order is issued, the recognition and enforcement of, and compliance with, the corresponding foreign laws and measures in China and by Chinese parties will be prohibited.<sup>7</sup> The prohibition order will apply generally, not only to the company or individual that made the initial report. A Chinese party may apply for an exemption from complying with a prohibition order, although the Measures do not specify the instances when such an exemption will be granted.<sup>8</sup>

The Measures provide that a Chinese party injured by another party’s compliance with extraterritorial measures subject to a prohibition order may sue in a Chinese court for damages, unless the putative defendant has applied for and received an exemption. Additionally, when a judgment or ruling based on extraterritorial measures made under foreign law (in whatever jurisdiction) causes losses to a Chinese party, that Chinese party may sue the person who benefits from such judgment or ruling for corresponding damages in a Chinese court.<sup>9</sup>

A Chinese party’s non-compliance with the reporting obligation or a prohibition order may be subject to administrative punishments such as a warning letter, an administrative order, and/or monetary penalties.<sup>10</sup> No criminal liability is prescribed by the Measures, and there is no provision for administrative penalties against non-Chinese parties.

In addition to the above, the Measures state that the Chinese government may adopt other countermeasures against unjustified extraterritorial application of foreign laws and measures.<sup>11</sup> It is unclear what these countermeasures could be at this point in time.

## APPLICATION OF THE MEASURES

Although immediately effective, the Measures currently consist only of the reporting obligation, as no prohibition orders have been issued.

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<sup>6</sup> “其他应当考虑的因素”

<sup>7</sup> *Id.*, Art. 6, 7.

<sup>8</sup> *Id.*, Art. 8.

<sup>9</sup> *Id.*, Art. 9.

<sup>10</sup> *Id.*, Art. 13.

<sup>11</sup> *Id.*, Art. 12.

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Exactly what could constitute an unjustifiable extraterritorial application of law is not entirely clear. The Measures apply to foreign legislation or government actions that restrict a Chinese party's ability to conduct business with "a third country or region or its citizens, legal persons or other organizations."<sup>12</sup> Chinese individuals and companies that lose business opportunities due to sanctions against third countries or entities clearly would be covered by the Measures, as would Chinese individuals and companies made subject to secondary sanctions due to their business with third-country sanctioned entities. It is unclear how the Measures apply when Chinese companies and individuals themselves are subject to primary sanctions, in particular U.S. primary sanctions against Chinese entities that purport to restrict only U.S. persons. Such sanctions are arguably not extraterritorial, but often involve practical consequences in dealings with third countries or regions. It remains to be seen if such sanctions will be dealt with by the work mechanism established under the Measures or whether they will be addressed by additional Chinese legislative action.

There is also a lack of clarity around when the reporting obligation is triggered. Does it attach at the time Chinese parties are entering into a contract containing undertakings to comply with foreign sanctions laws?<sup>13</sup> Or is the reporting obligation only triggered when circumstances arise likely to impede business with a third country or region? As Chinese parties are subject to administrative penalties for failure to make such a report and/or may need to apply for an exemption, Chinese parties are likely to err on the side of earlier reporting. Although there is no penalty proscribed for foreign companies requesting the inclusion of trade controls clauses in agreements, being frequently reported to the "work mechanism" for making such demands is unlikely to endear such companies to PRC regulators. Until further guidance is received, foreign companies entering into contracts or joint ventures with Chinese parties will want to carefully consider the wording of any such provisions and how to allocate risk in the event of a prohibition order being issued.

Finally, it is not entirely clear whom Chinese parties injured by extraterritorial laws can sue. A question left by the Measures is whether Chinese courts have extraterritorial jurisdiction to enforce them. The language of the Measures indicates that a Chinese party may bring a lawsuit against "any person" for damages caused by unjustified extraterritorial application of foreign laws. Although the EU's blocking statute has similar language, which says, "such recovery may be obtained from the natural or legal person or any other entity causing the damages or from any person acting on its behalf or intermediary," it has a personal jurisdiction clause that limits its application to EU

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<sup>12</sup> As Hong Kong is a "special administrative region" of China, it is likely that damages resulting from compliance with sanctions imposed under the Hong Kong Autonomy Act would result in obligations and remedies under the Measures.

<sup>13</sup> As would be required under U.S. anti-boycott regulations, see 15 C.F.R. §760.5.

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persons. The lack of a similar personal jurisdiction clause under the Measures and the deliberate difference of wording in the remedy clause (use “a person”<sup>14</sup> instead of “citizens, legal persons and other organizations of China”<sup>15</sup> used in other clauses) seem to suggest that a Chinese court’s jurisdiction under the Measures is not limited to Chinese parties. However, the same clause has a proviso, specifying that “a person”<sup>16</sup> who is exempted from complying with a prohibition order may not be sued. As only Chinese parties can apply for such an exemption,<sup>17</sup> the Measures could be read to limit jurisdiction to Chinese parties.

## CONCLUSION

The Measures pose challenges to both Chinese and foreign businesses with regard to existing and future relationships. Chinese parties will need to consider reporting obligations and foreign parties doing business with Chinese parties may find themselves subject to litigation in China based on their adherence to foreign extraterritorial laws while finding provisions in existing contracts giving them the right to do so unenforceable. However, nothing has so far been prohibited under the Measures and questions about their application in practice remain. Both foreign and Chinese companies will have to exercise caution as they wait to see how the work mechanism functions in practice.

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Please do not hesitate to contact us with any questions.

*Debevoise & Plimpton LLP, like other international firms in China, is not admitted to practice PRC law. Our views are based on our general experience in dealing with similar matters and consultation of published compilations of Chinese law. We would be pleased to arrange for assistance from licensed Chinese counsel should you require a formal opinion as to any of the matters set forth in this update.*

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<sup>14</sup> The original Chinese term is “当事人.”

<sup>15</sup> The original Chinese term is “中国公民、法人或者其他组织.”

<sup>16</sup> The original Chinese term is “当事人.”

<sup>17</sup> The original Chinese term is “中国公民、法人或者其他组织可以向国务院商务主管部门申请豁免遵守禁令.”

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