

# China Issues Rules to Counteract “Unjustified” Extraterritorial Application of Foreign Measures

January 12, 2021

International Trade

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On January 9, 2021, China’s Ministry of Commerce (“**MOFCOM**”) released the *Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures* (the “**Rules**”), which took effect immediately. Specifically, the Rules are designed to “counteract” the extraterritorial application of “foreign [i.e., non-Chinese] legislation” or “measures” when such application “unjustifiably” prohibits or restricts a Chinese citizen, entity or other organization (collectively, “**Chinese Party**”) from engaging in “normal business activities” with “parties of a third country (region)” “in violation of international law and the basic principles of international relations.” As such, the Rules could expose Chinese Parties (including foreign-invested enterprises established in China, such as Chinese subsidiaries of multinational companies) to reporting requirements related to the possible application of such foreign rules and to administrative penalties for failing to report. Also, companies (possibly both within and outside of China) complying with non-Chinese measures prohibited under the Rules could face litigation in China. A MOFCOM-issued English translation of the Rules is available [here](#).

MOFCOM also released two short Q&A articles (the “**Q&As**”) on its website in an effort to shed light on the interpretation and enforcement of the Rules. The Q&As explain that so-called “secondary sanctions” (usually referring to the enforcement of U.S. economic sanctions with respect to non-U.S. persons that engage in transactions with sanctioned parties) are the main target of the Rules. But the wording of the Rules is vague and could be interpreted much more broadly to cover many other scenarios where non-Chinese measures with extraterritorial components are enforced.

This alert addresses four questions regarding the Rules that will be of interest to companies and highlights the knowns and unknowns of this new regulation.

## **1. What kinds of extraterritorial applications of non-Chinese measures could be regarded as “unjustified” and “in violation of international law and the basic principles of international relations”?**

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The threshold question posed by the Rules is to identify whether an extraterritorial application of a non-Chinese measure is “unjustifiable.” To this end, the Rules provide that a working mechanism led by MOFCOM with participation by the National Development and Reform

Commission (“**NDRC**”) and other central-level authorities (“**Working Mechanism**”) will weigh the following four factors:

1. whether such an application is in violation of international law and basic principles of international relations;
2. potential impact on China’s national sovereignty, security, and development interests;
3. potential impact on the legitimate rights and interests of Chinese citizens, entities, or other organizations of China; and
4. other factors that shall be taken into account.

The Rules explicitly carve out the extraterritorial application of non-Chinese measures as provided for in treaties or international agreements to which China is a party.

Although the Working Mechanism enjoys final discretion in determining whether an extraterritorial application of non-Chinese measures is justified based on the vague description of the factors to be considered, the wording could suggest that an application of non-Chinese measures based on international law principles such as territorial and nationality jurisdiction could be recognized as justified. Given that more and more recently enacted Chinese laws contain provisions that allow extraterritorial application of such laws, it is possible that the Rules are targeting a narrower set of extraterritorial applications that are considered by the Chinese authorities to be outside the boundaries of traditional international law with respect to a country’s jurisdiction over parties in third countries, but still working to preserve their ability to apply Chinese laws to certain persons and types of conduct outside of China.

## **2. What companies might be subject to a reporting obligation under the Rules?**

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Similar to blocking statutes in other jurisdictions, the Rules impose a reporting obligation on Chinese Parties, i.e., if a Chinese Party is prohibited or restricted from engaging in normal business activities with parties of third countries/regions due to non-Chinese laws or measures, the Chinese Party must report such matter to MOFCOM within 30 days. Such matters can be kept confidential if requested by the Chinese Party. Note that the reporting is mandatory, and failure to report may lead to warnings or fines by MOFCOM.

It is expected that foreign-invested entities in China (e.g., a Chinese subsidiary of a multinational corporation) will be subject to these reporting obligations, as they are legal persons organized under the laws of China.

## **3. What is a Prohibition Order under the Rules? What are the penalties for violating a Prohibition Order?**

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Once an extraterritorial application of a non-Chinese measure is deemed “unjustifiable,” MOFCOM is authorized to issue a prohibition order (“**Prohibition Order**”) not to accept, execute, or observe the relevant non-Chinese measure. Such a Prohibition Order can be suspended or withdrawn based on changes in circumstances. In the Q&As, MOFCOM did not directly indicate whether any Prohibition Orders will be released soon; instead, MOFCOM indicates that the Chinese government will “closely track” any unjustifiable extraterritorial

application. The Rules do not explicitly clarify whether the Prohibition Order is addressed only to Chinese Parties or to a larger target audience.

Similar to blocking statutes in other jurisdictions, the Rules allow a Chinese Party to apply for an exemption from complying with a Prohibition Order by filing a written application to MOFCOM, specifying the reasons for and scope of the requested exemption, although the Rules do not list what factors MOFCOM will consider when reviewing such applications. Except for emergency cases, a decision will be made within 30 days of acceptance of the application.

Unless an exemption has been granted, complying with non-Chinese measures that are the subject of a Prohibition Order and deemed to infringe upon the legitimate rights and interests of a Chinese Party can lead to administrative penalties (including fines) for Chinese Parties and/or civil lawsuits for damages (potentially for both Chinese and non-Chinese parties). The Rules do not specify amounts of potential fines.

#### **4. What remedies can a Chinese Party seek under the Rules?**

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The Rules provide remedies to a Chinese Party who suffers losses as a result of the unjustifiable extraterritorial application of non-Chinese measures that are the subject of a Prohibition Order. First, the Chinese Party can seek “support” from the relevant department of the Chinese government. Such support, based on the Q&As, may include guidance and services, as well as “necessary support” for the loss suffered. However, it is not clear whether monetary compensation is included.

Second, the Chinese Party can initiate litigation in Chinese courts against: (i) companies or individuals complying with the non-Chinese measures that are the subject of a Prohibition Order, and (ii) companies or individuals benefiting from a judgment or ruling (presumably outside of China) that is made against a Chinese Party based on the non-Chinese measures that are the subject of a Prohibition Order and cause damages. It is unclear how such litigation will proceed in Chinese courts and how damages will be calculated. Also, although not explicitly confirmed, it may be inferred from the wording of the Rules that non-Chinese parties may also be potential defendants in these lawsuits, and judgments against such defendants would be enforceable in China.

Finally, the Rules provide that the Chinese government may take necessary countermeasures in response to unjustified extraterritorial application of non-Chinese legislation or measures. In the Q&As, MOFCOM does not directly indicate what sorts of “countermeasures” may be taken.

Overall, the Rules offer companies, in particular Chinese companies that are adversely affected by the extraterritorial application of non-Chinese measures, a path to seek “support” from the Chinese government and potentially recover losses by filing lawsuits in China, therefore mitigating the impact of non-Chinese measures on Chinese companies doing business in and with parties of third countries. However it could present significant challenges to multinational companies operating in China, who are already under pressure to cope with foreign regulatory requirements, as the Rules introduce additional (and potentially competing) obligations to comply with the requirements of the Chinese government, such as the reporting obligation and the obligation to comply with or apply for exemption from a Prohibition Order.

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Although MOFCOM indicated in the Q&As that the Rules are aimed at protecting the legitimate interests of Chinese Parties and do not target any specific country or type of transactions, it seems the primary impact of the Rules would be on the enforcement of U.S. export controls or economic sanctions -- for example, with respect to transactions with suppliers in Korea or Taiwan that are blocked by U.S. export controls, or Chinese companies doing business in or with counterparties in Iran or other sanctioned countries.

It remains unclear how the Rules will function in practice, especially with respect to the scope and scale of remedies that will be available to the affected Chinese Parties, and the types of non-Chinese legislation or measures that are most likely to be subject to Prohibition Orders. (Unlike similar blocking statutes adopted by other countries, the Rules do not reference a specific list of non-Chinese measures.) As with many Chinese laws and regulations, the Rules appear to give the Chinese authorities considerable discretion in their interpretation and enforcement. Balancing the expectations of foreign regulatory regimes with the new requirements under the Rules will be key for companies to successfully navigate conflicting enforcement scenarios.

Along with the [Unreliable Entity List](#) and the recently enacted [Export Control Law](#), the Rules provide the Chinese government with additional tools to counter laws and regulations from other countries that are perceived to affect the interests of the Chinese government.

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