



FANGDA PARTNERS
方達律師事務所

**CHINA ISSUES
BLOCKING STATUTE
AGAINST IMPROPER
EXTRA-TERRITORIAL
APPLICATION OF
FOREIGN LAWS**

Authors:



Kate Yin
Partner, Fangda Partners
kate.yin@fangdalaw.com



Jason Li
Partner, Fangda Partners
jason.li@fangdalaw.com



Derrick Zhao
Partner, Fangda Partners
derrick.zhao@fangdalaw.com



Yingjie Kang
Counsel, Fangda Partners
yingjie.kang@fangdalaw.com

On January 9, 2021, the Ministry of Commerce ("**MOFCOM**") issued the Order No. 1 of 2021 to promulgate the *Rules on Counteracting Unjustified Extra-territorial Application of Foreign Legislation and Other Measures* (the "**Blocking Rules**"), and officially introduced the long-awaited version of China's *Blocking Statute*.

The Blocking Rules reflect the efforts of China to establish blocking mechanisms against the improper application of the "long-arm jurisdiction" of foreign laws on Chinese enterprises and also offer scope for compensation for Chinese enterprises adversely affected by foreign laws and sanctions.

This article introduces the key contents of the Blocking Rules and also discusses their impact on Chinese and non-Chinese enterprises.

I. Framework of the Blocking Rules

Applicability: Article 2 of the Blocking Rules provides that the Blocking Rules apply to situations where foreign laws and other measures unjustifiably prohibit or restrict the citizens, legal persons or other organizations of China ("**Subjects of China**") from engaging in normal economic, trade and related activities with a third country (or region) or its citizens, legal persons or other organizations ("**Subjects of a Third Country**").

Working Mechanism: the Blocking Rules provide that an inter-departmental body (the "**Working Mechanism**") led by the MOFCOM and joined by the National Development and Reform Commission (the "**NDRC**") and other departments is responsible for considering whether there has been unjustified extra-territorial application of foreign laws and other measures.

The Blocking Mechanism: The Blocking Rules establish the basic process to counteract unjustified extra-territorial application of foreign laws and measures through several steps:

- Reporting Obligations: When a Subject of China is prohibited or restricted by foreign legislation and other measures from engaging in normal economic, trade and related activities with a Third Country or Subjects of a Third Country, this matter should be reported to MOFCOM within 30 days.
- Injunctions: If the Working Mechanism determines that the extra-territorial application of applicable foreign laws or measures is unjustified, it may decide that MOFCOM shall issue an injunction to the effect that the applicable foreign legislation and other measures shall not be recognized, implemented or complied with.
- Application for Exemption: Subjects of China can apply to the MOFCOM for exemption from compliance with an injunction.
- Judicial Remedy: Where a person complies with the foreign laws and other measures within the scope of an injunction, and thus infringes the legitimate rights and interests of a Subject of China, the Subject of China can file a lawsuit in a Chinese court against such person and make a claim for compensation. If a judgment or ruling made under a foreign law within the scope of the injunction causes a Subject of China to suffer damages, the Subject of China may also file a lawsuit in a Chinese court to claim for compensation from the person who benefits from the aforementioned judgment or ruling.

This article is undoubtedly the most eye-catching of the Blocking Rules. Note that the "person" here does not explicitly exclude foreign subjects. This may exert pressure on foreign subjects considering abiding by such foreign laws and measures, and increase the possibility of excluding the application of such foreign laws and measures.

- Supporting Measures: If a Subject of China suffers significant losses resulting from non-compliance with the applicable foreign legislation and other measures in order to abide by the injunction, government departments may provide support (i.e. financial compensation) based on the particular circumstances.

Legal liability: The Blocking Rules provide that any person who violates the obligation of truthful reporting or fails to comply with the injunction shall be given a warning, ordered to adhere to the injunction within a specified period of time, and may be punished with a fine, among other measures, depending on the circumstances.

II. Impact of the Blocking Rules

There are very urgent practical considerations that have led to the introduction of the Blocking Rules. In the U.S.-China trade war in the past two years, the U.S. has been using economic sanctions and export control measures more and more frequently, which have a very clear extra-territorial effect. It is, of course, not just Chinese enterprises that are affected, the impact is felt by companies of all countries that have dealings with the U.S.

Consider this example: a Chinese company (Company A) had normal trade transactions with a Venezuelan state-owned enterprise (Company B), and then the U.S. placed Company A on the SDN list on the grounds that it violated U.S. sanctions against Venezuela by transacting with Company B. Thereafter, shipping, freight forwarding, insurance, banking and other institutions with which the Company A had normal business dealings (all non-U.S. foreign companies, collectively referred to as Company C) terminated their cooperation with Company A for fear of being sanctioned by the U.S., causing great losses to Company A. This scenario has been very common in the past few years, and more companies, in turn, have had to suspend or abandon their original trade or investment plans because of their concerns about sanctions imposed by the U.S. government.

The Blocking Rules provide a channel of relief in the above situation. After the Blocking Rules take effect, Company A is obliged to report the situation to MOFCOM, and the Working Mechanism will conduct a comprehensive assessment of the situation. If the assessment concludes that there is an unjustified extra-territorial application of U.S. laws, MOFCOM may issue an injunction against the designation of Company A on the SDN list or laws and regulations, which can be viewed as an announcement by China that the designation of Company A or the legal basis of the designation, depending on the target of injunction, is invalid.

According to the Blocking Rules, any party that disregards the injunction and chooses to comply with the U.S. sanction measures against Company A may be sued by Company A if Company A suffers losses. The injunction will put greater pressure on companies that refuse to deal with companies in the position of Company A as a result of its inclusion on the SDN list to consider their response more carefully. In practice, what we have often seen after Chinese companies have been included on the SDN list or other similar trade black list is that their business partners immediately refuse to honor their contractual obligations for fear of violating U.S. sanction measures. The Blocking Measures may help reverse such trend.

III. Issues to be Clarified

The Blocking Rules draw on internationally accepted practices and, additionally, offer some extra provisions to deal with the unjustified extra-territorial application of foreign laws and measures. At the same time, they provide a range of remedies to protect the legitimate rights and interests of Chinese enterprises. However, there are still many issues that need to be further clarified in practice.

Question 1: What Events Trigger Reporting Obligations?

According to Article 5 of the Blocking Rules, what needs to be reported is the situation where a Subject of China is prohibited or restricted by foreign laws and other measures from engaging in normal economic, trade and related activities with a Subject of Third Country. In this case, we would take it to mean that Company A would be required to report to MOFCOM within 30 days of being included on the SDN list and also to report to MOFCOM a second time when Company C stops cooperating with Company A.

Unlike the EU Blocking Statute (see below), the Blocking Rules do not explicitly list the foreign laws and measures to be blocked. The U.S. secondary sanctions have long been criticized for their unreasonable long-arm jurisdiction as their application does not require a U.S. nexus. If a company is prohibited from transacting with the Subject of Third Country due to the U.S. secondary sanctions, such a situation would clearly trigger the reporting obligation under the Blocking Rules.

In addition, the U.S. primary sanctions and export control measures also have extra-territorial application (for example, on the engagement of U.S. personnel, the use of U.S. dollars in transactions, and the inclusion of U.S.-origin contents or technologies in products), and if an enterprise is subject to the corresponding restrictions, it may also be obliged to report under the Blocking Rules. However, it remains to be seen whether the U.S. primary sanctions and export control measures may also be considered to be "unjustified application" by the Working Mechanism, given the existence of a U.S. nexus.

In addition, would the Blocking Rules apply in the situation where an enterprise voluntarily abandons or ceases affected activities purely due to the fear of extra-territorial application of foreign laws? For past investments and trade activities that have been abandoned or stopped due to "secondary sanctions", will the reporting obligation still be triggered? These are all issues that will require more specific guidance from the Chinese authorities.

Question 2: Applicable Situations and Targets of Injunctions

The injunction is the core mechanism that has been established by the Blocking Rules. Once an injunction is issued, it is binding on all individuals or entities in China. But there are still some questions that remain to be clarified in practice.

First of all, would any injunction apply to foreign subjects? While an injunction as an administrative order issued by the Chinese government primarily regulates Chinese entities and activities in China, the impact of the Blocking Rules will be greatly reduced if the injunction does not apply to foreign entities. For example, in the above case, if the injunction cannot be applied to Company C, the situation of Company A could not be fundamentally improved.

Second, although the injunction applies to Chinese subjects, if the economic and trade relationship itself does not

involve the relationship between "Subjects of China and Subjects of Third-country", can the injunction still apply?

In recent years, many Chinese companies have been placed on the U.S. export control Entity List, and a scenario often arises in practice, as follows: U.S. manufacturer D sells U.S.-origin equipment to Chinese Company A through its subsidiary E in China. If Company A is included on the Entity list, Company D and its subsidiary E in China will stop selling equipment or providing follow-up technical support to Company A on the grounds that it has to comply with U.S. export control regulations.

Under such circumstances, can Company A report to MOFCOM and then apply for an injunction? If an injunction is issued to invalidate the restrictions on Company A, should Company E comply with the injunction and continue to sell to Company A? If Company E chooses to disregard the injunction and continues to comply with export restrictions under the EAR against Company A, can Company A file a lawsuit against Company E on the grounds of the Blocking Rules?

Article 2 of the Blocking Rules provides that the rules only apply to situations where foreign laws and other measures unjustifiably prohibit or restrict the Subjects of China from engaging in normal economic, trade and related activities with Subjects of a Third Country. In the above situation, Company A's transactions with Company D or Company E do not seem to meet the above circumstances, and therefore theoretically it would be difficult to apply for an injunction against the sanctions measures or to file a lawsuit against Company D or Company E. However, if Company D or Company E's cut-off behavior causes Company A to have difficulty in carrying out economic and trade activities with Subjects of Third Countries, the possibility of applying the injunction cannot be completely excluded. How this situation may be regulated in practice by the Blocking Rules remains to be clarified.

Question 3: Judicial Remedies

As mentioned above, since the Blocking Rules have "protecting the legitimate rights and interests of Subjects of China" as their principal purpose, the "persons" which can be sued for disregarding injunctions and causing damages to Subjects of China should, in theory, be limited to Chinese individuals or entities.

One key question to be clarified is the relationship between the judicial remedy through the Blocking Rules and the existing dispute resolution mechanism in the affected transactions.

For example, in standard practice, participants in international "economic, trade and related activities" often agree on the applicable law of the transaction and the dispute resolution mechanism in the event of a dispute, which may include either court litigation or arbitration in China or abroad. The legality of such an agreement is confirmed by the top-level legislation of China and the international treaties. Thus, in the case of the application of the Blocking Rules, the following question arises: when the other "party" comply with the foreign laws and measures referred to in the Blocking Rules and cause damage to Chinese parties, should the Chinese parties seek remedies in accordance with agreed dispute resolution clauses or choose to file a lawsuit in a Chinese court under the Blocking Rules?

These are questions that touch on fundamental issues of how a country's judiciary intervenes in international trade and economic affairs and the interconnection between the courts and arbitration as methods of resolving disputes. These questions will doubtless be given full attention in subsequent implementation of the Blocking Rules and coordinated in individual cases.

IV. Practice of the European Union Blocking Statute and Prospect of Law Enforcement in China

The Blocking Rules draw heavily on the EU Blocking Statute, such as the reporting system, prohibition of compliance with foreign laws, application for exemption, and judicial remedy. The main difference between them is that the EU Blocking Statute lists the names and specific contents of the foreign laws that are the subject of the blocking. In addition, the EU Blocking Statute does not provide for penalties for non-compliance with the statute, but requires each member state to set out and enforce its own penalties on any individual or company found not to comply.

The analysis of the institutional framework and implementation of the EU Blocking Statute is an important reference for looking ahead to the future implementation of the Blocking Rules in China. This is despite the fact that there are not many cases of actual application, largely due to the failure of EU member states to enforce the legislation. However, the introduction of the EU Blocking Statute is still an important legislative attempt by the international community to curb the "long-arm jurisdiction" of some countries. In our assessment, the "Blocking Rules" draw strongly on the EU's "Blocking Statute", while adding a number of further innovations. When it comes to formulating the implementing rules, we believe the Chinese authorities will take into account the EU experience and make every effort to ensure that the corresponding Chinese rules are effective, as well strengthening enforcement and judicial protection.

The introduction and implementation of the Blocking Rules offer Chinese enterprises additional protection as they operate in a complex overseas compliance regulatory environment. The introduction of the Blocking Rules will inevitably have an impact on the compliance steps need to be taken by third-country entities affected by foreign laws and measures, as well as by foreign-invested companies in China. Our advice to any company that does engage in international trade and commerce to study the Blocking Rules without delay and see whether they might be affected.

Should you have any questions, please feel free to reach out to Fangda.

** Our associate Vincent Wang and intern Chi Zhang also contributed to this article.*

Beijing

27/F, North Tower
Beijing Kerry Centre
1 Guanghua Road
Chaoyang District
Beijing 100020, China

Tel: +86 10 5769 5600
Fax: +86 10 5769 5788

Guangzhou

17/F, International Finance
Place, 8 Huaxia Road,
Zhujiang New Town
Guangzhou 510623, China

Tel: +86 20 3225 3888
Fax: +86 20 3225 3899

Hong Kong

26/F, One Exchange Square
8 Connaught Place, Central
Hong Kong

Tel: +852 3976 8888
Fax: +852 2110 4285

Shanghai

24/F, HKRI Centre Two,
HKRI Taikoo Hui
288 Shi Men Yi Road
Shanghai 200041, China

Tel: +86 21 2208 1166
Fax: +86 21 5298 5599

Shenzhen

17/F, Tower One, Kerry Plaza
1 Zhong Xin Si Road
Futian District
Shenzhen 518048, China

Tel: +86 755 8159 3999
Fax: +86 755 8159 3900